

# **Community Assistantship Program**

Best Practices in Microlending

Prepared in partnership with  
North East Entrepreneur Fund

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# BEST PRACTICES IN MICROLENDING

Jose Y. Diaz

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University of Minnesota

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Minnesota

June, 2008

## CONTENTS

<b>BACKGROUND AND OBJECTIVES .....</b>	<b>3</b>
<b>RESEARCH METHODOLOGY .....</b>	<b>3</b>
<b>RESPONDENT PROFILE .....</b>	<b>4</b>
<b>LOANS.....</b>	<b>6</b>
<b>LOAN EXPANSION EXPERIENCE .....</b>	<b>9</b>
<b>CUSTOMER PROFILE.....</b>	<b>11</b>
<b>LOAN SOLICITOR/UNDERWRITING PROFILE .....</b>	<b>16</b>
<b>MARKETING AND BUSINESS DEVELOPMENT/SALES STRATEGIES .....</b>	<b>21</b>
<b>BEST PRACTICES AND EXPANSION OF MICRO-LENDERS.....</b>	<b>23</b>
<b>INSTRUMENT .....</b>	<b>47</b>

## BACKGROUND AND OBJECTIVES

The North East Entrepreneur Fund has ongoing marketing and growth initiatives for its market. Knowledge of the marketing and expansion practices of other micro-lenders is needed to make decisions regarding the Fund's own expansion strategy. The objectives of the research are:

- To identify a set of best practices regarding growth of micro-lending institutions across the U.S.
- To define clusters of micro-lenders that share common expansionary strategies.
- To identify factors that may be determining the conformation of expansion clusters.

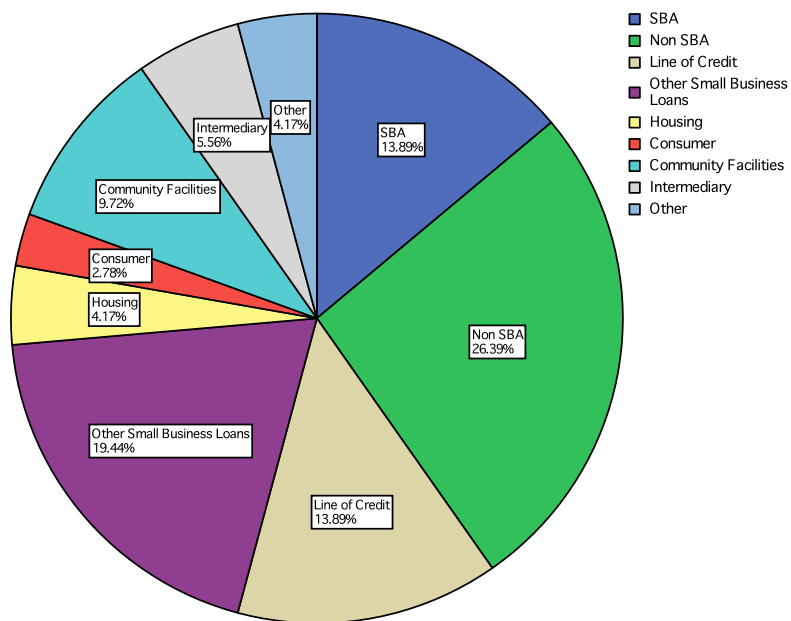
## RESEARCH METHODOLOGY

An electronic survey of 24 micro-lending organizations in the U.S. was conducted during March and April 2008. These organizations are business/micro-business lenders in 15 U.S. States. A total of 105 surveys were sent via email and 24 organizations completed the questionnaire for a response rate of 23 percent.

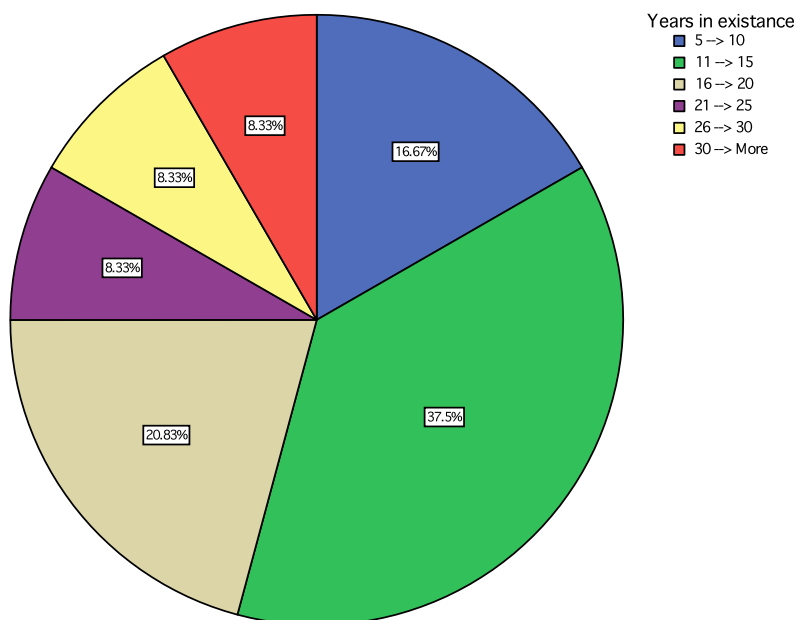
The survey's structure included five sections regarding, organizational characteristics, loan expansion experience, customer profile, loan solicitation, and productivity and marketing strategies.

## RESPONDENT PROFILE

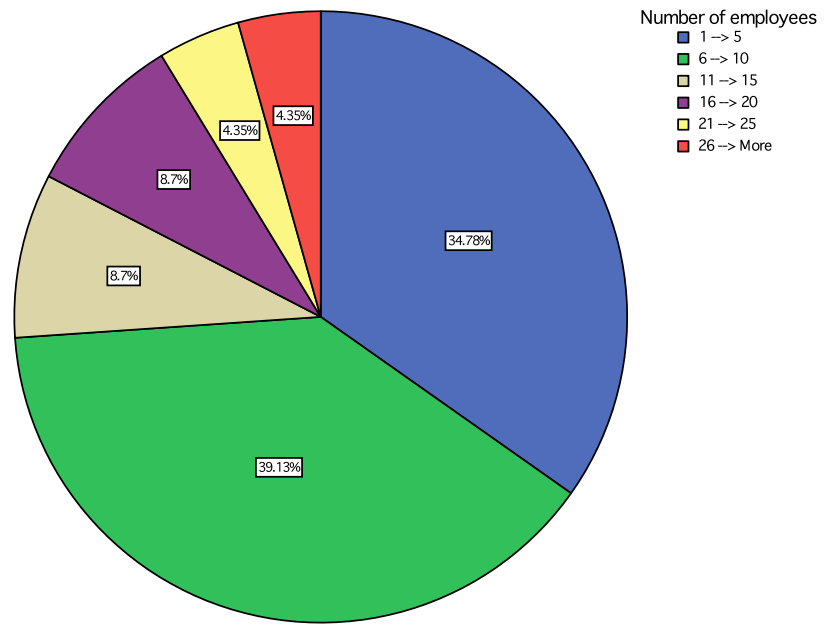
**Chart 1: Type of loans provided**  
n=24



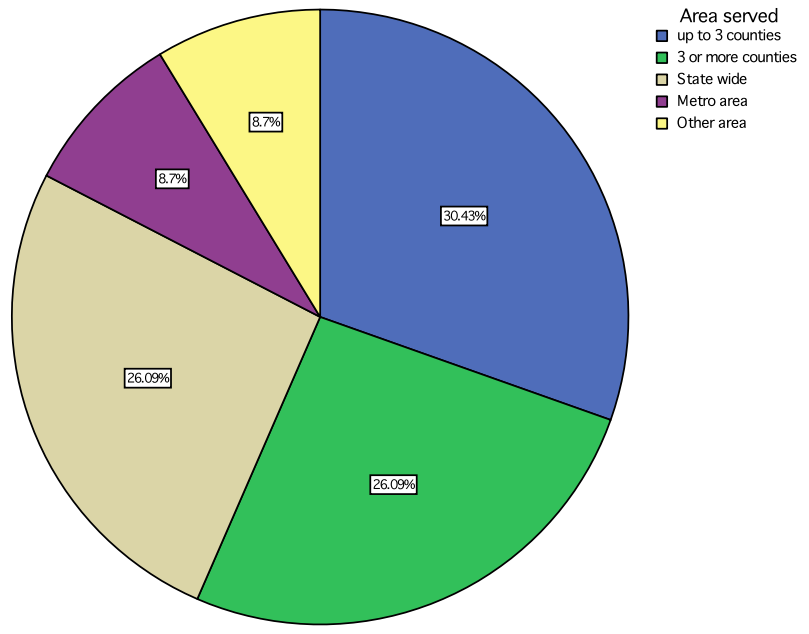
**Chart 2: Years in existence**  
n=24



**Chart 3: Number of employees**  
n=24



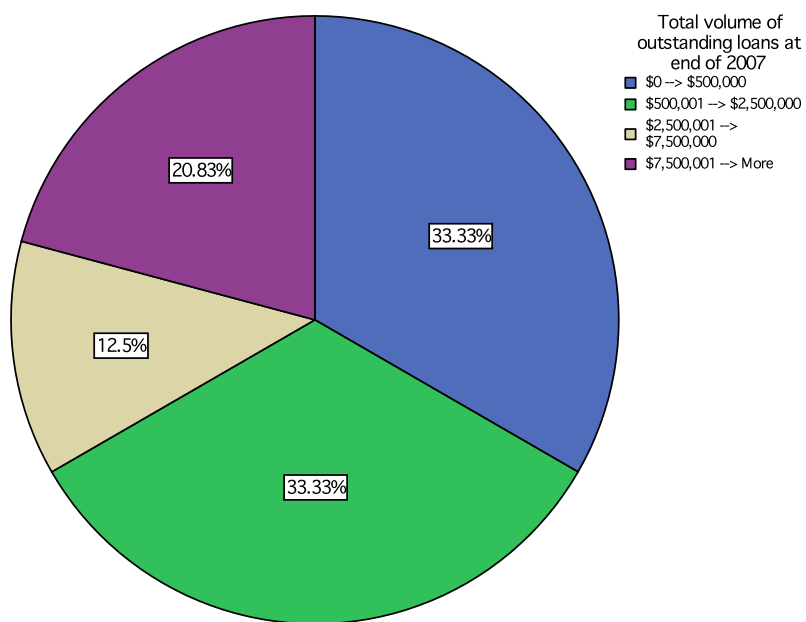
**Chart 4: Area served**  
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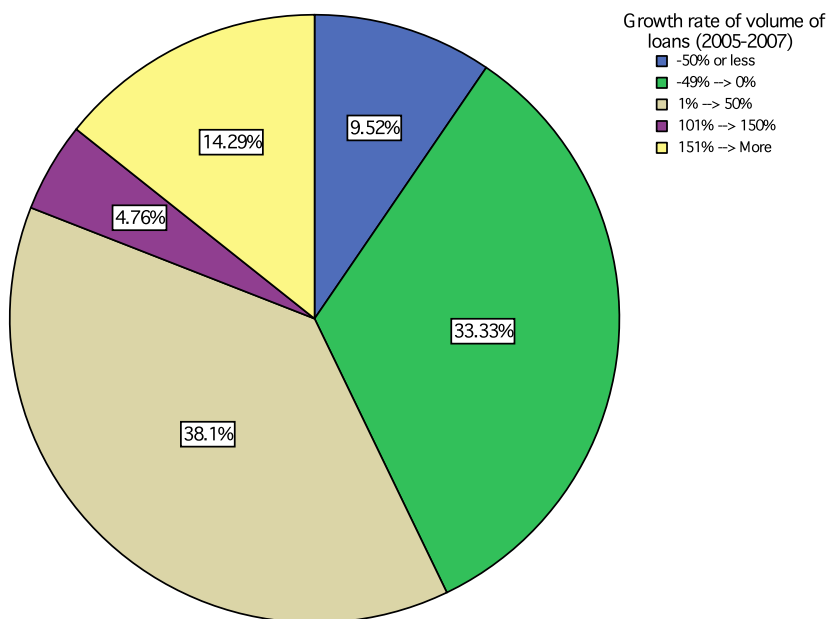


## LOANS

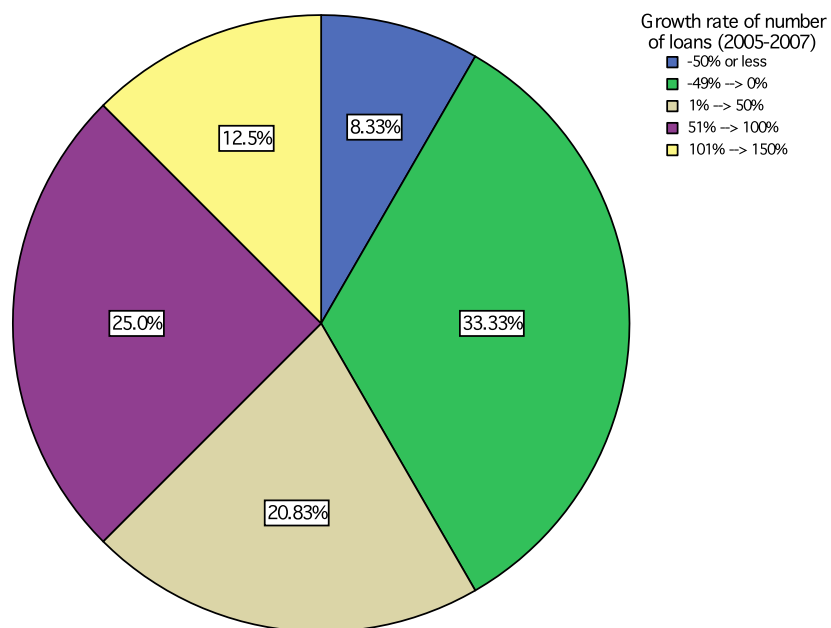
**Chart 5: Total volume of outstanding loans at the end of 2007**  
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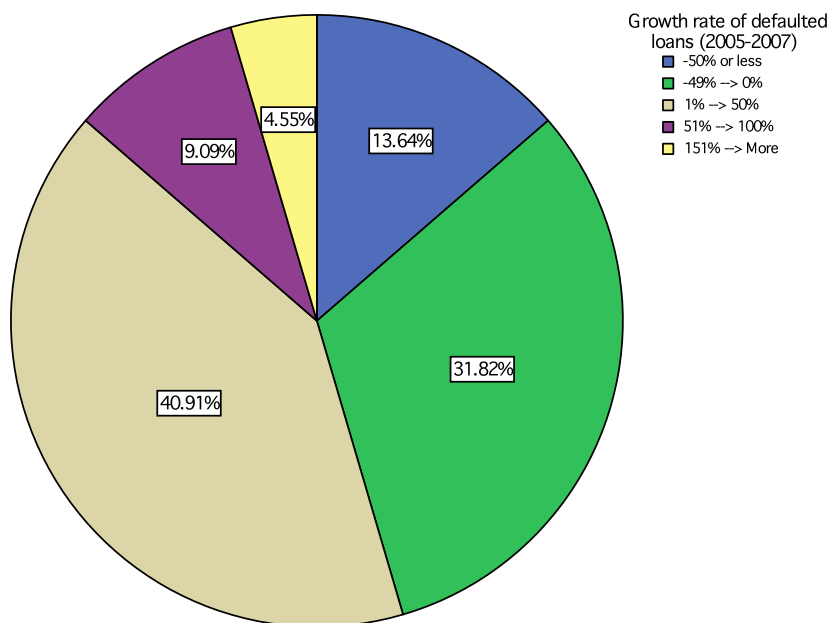
**Chart 6: Growth rate of volume of loans (2005-2007)**  
n=24



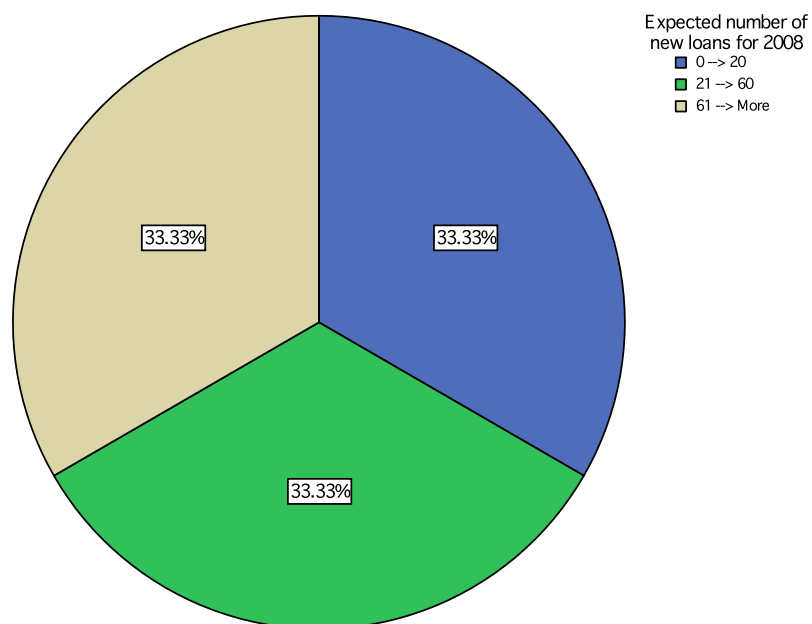
**Chart 7: Growth rate of number of loans (2005-2007)**  
n=24



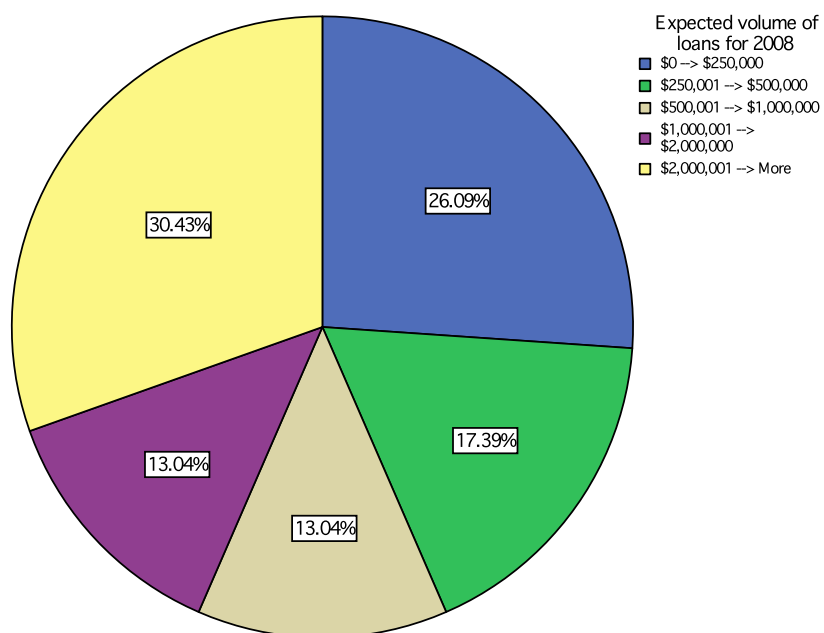
**Chart 8: Growth rate of defaulted loans (2005-2007)**  
n=24

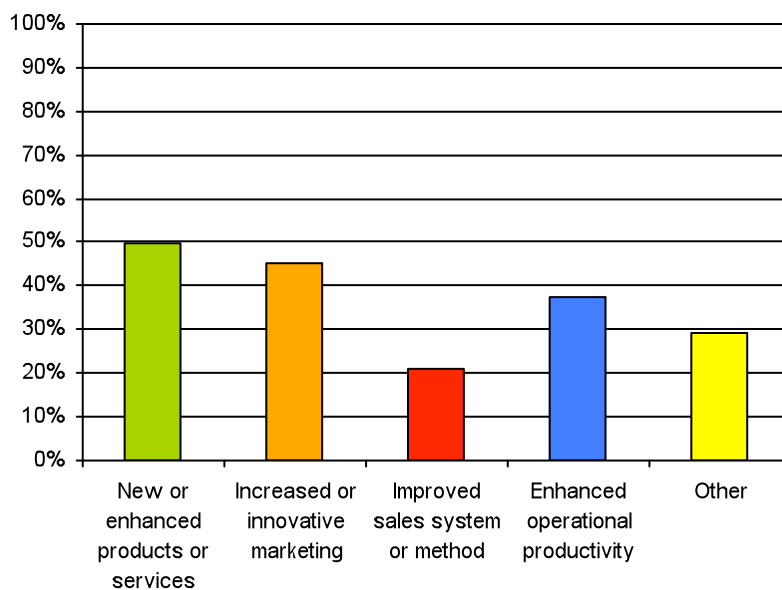
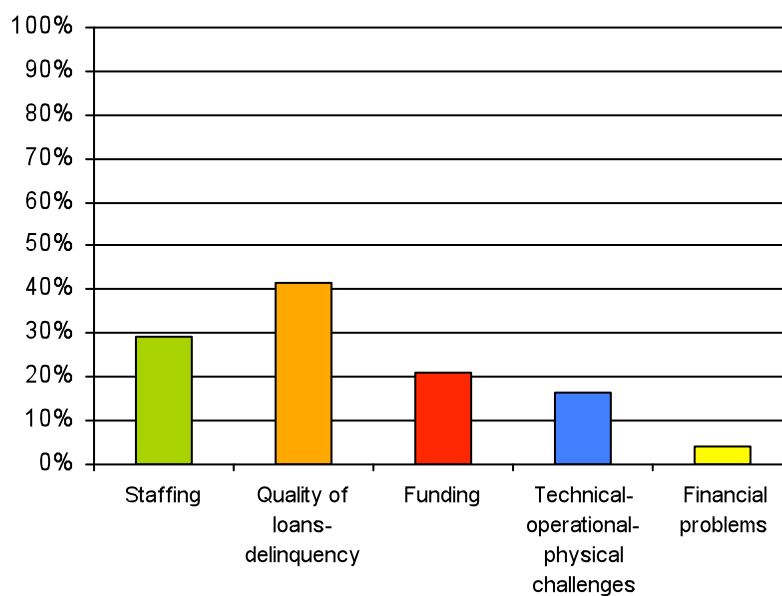


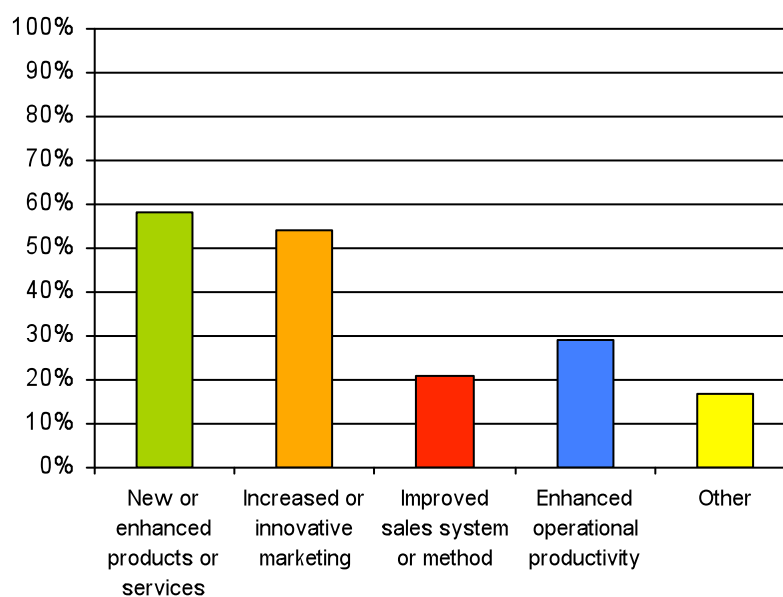
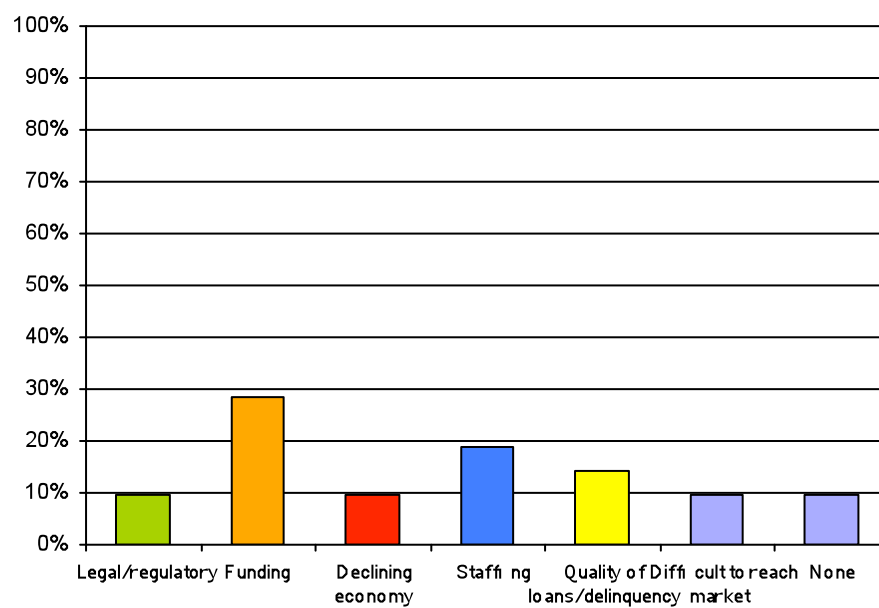
**Chart 9: Expected number of new loans for 2008**  
n=24



**Chart 16: Expected volume of loans for 2008**  
n=24

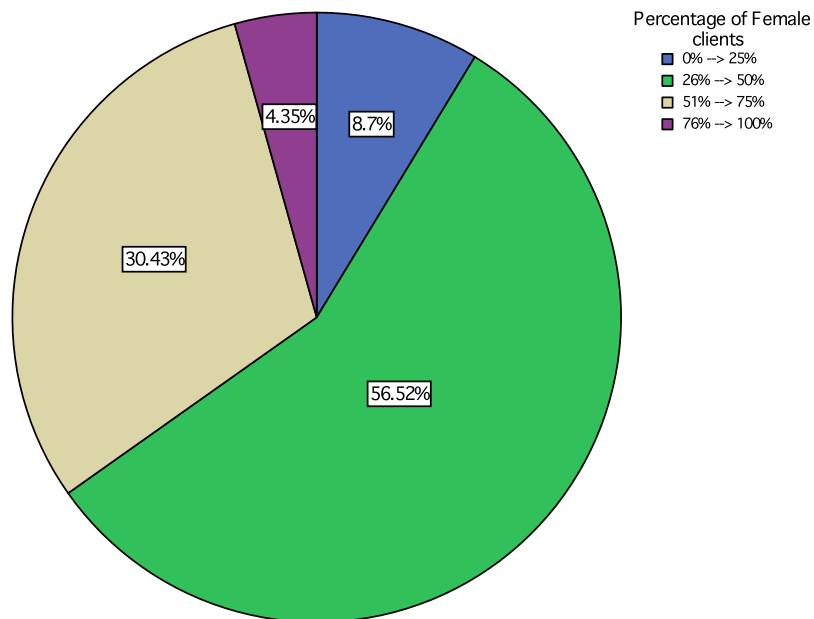


**LOAN EXPANSION EXPERIENCE****Graph 10: Expansion strategies implemented in the last three years****Graph 11: Challenges of expansion**

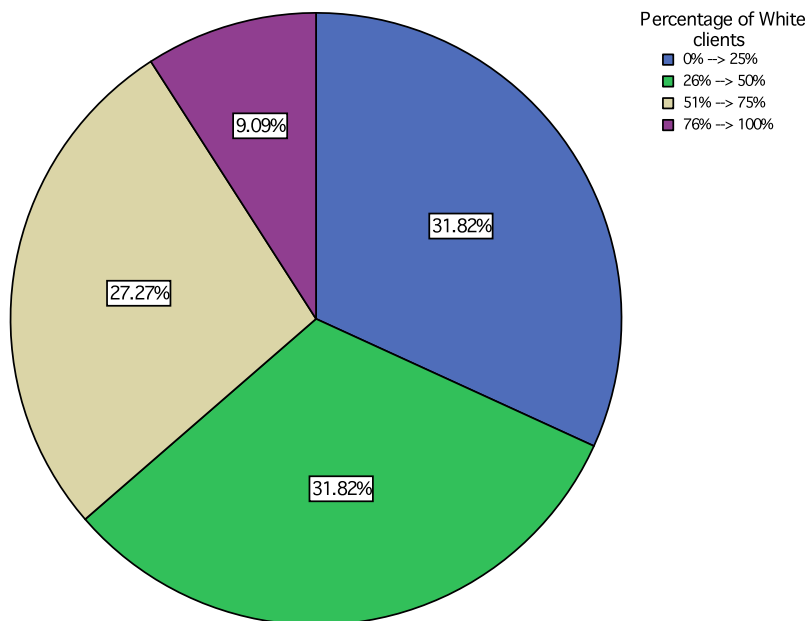
**Graph 12: Strategies for future expansion****Graph 13: Expected challenges of future expansion**

**CUSTOMER PROFILE**

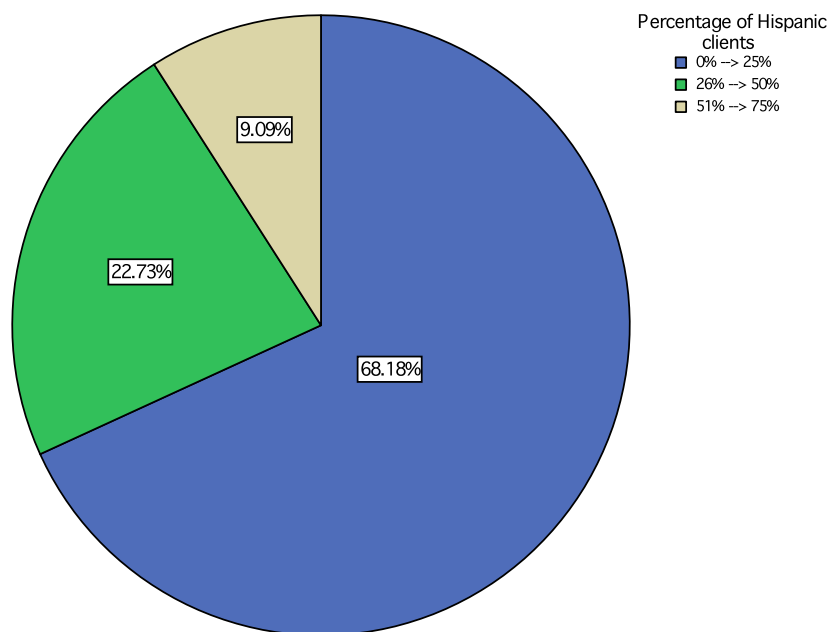
**Chart 14: Percentage of female clients**  
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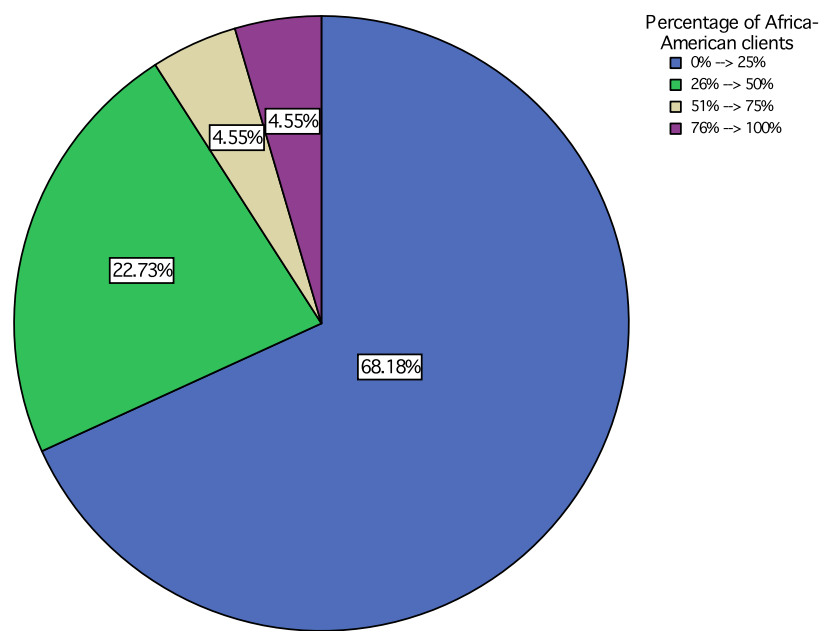
**Chart 15: Percentage of white clients**  
n=24



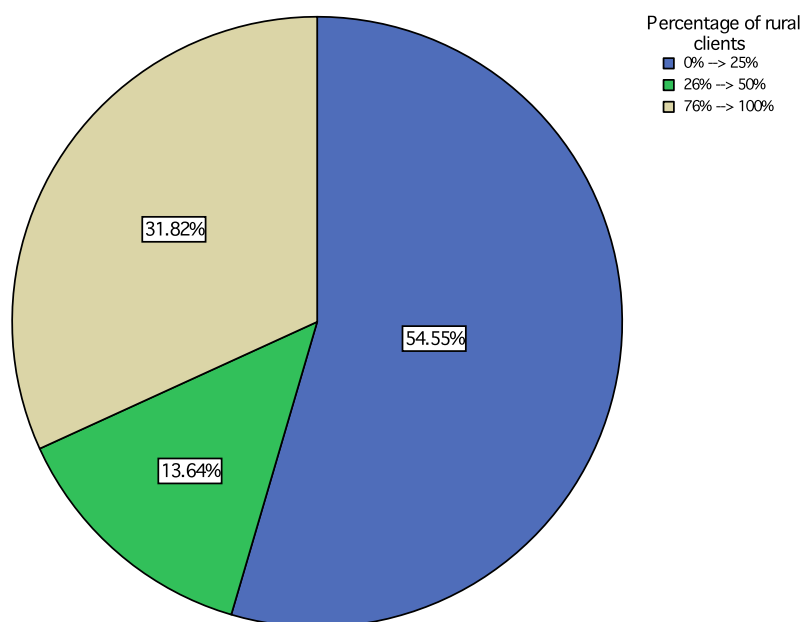
**Chart 16: Percentage of Hispanic clients**  
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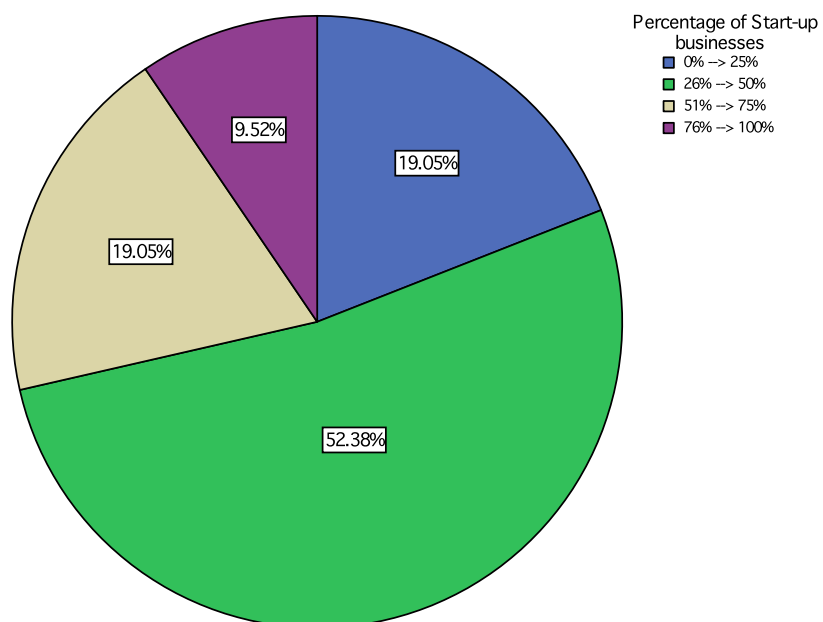
**Chart 17: Percentage of African-American clients**  
n=24



**Chart 18: Percentage of rural clients**  
n=24

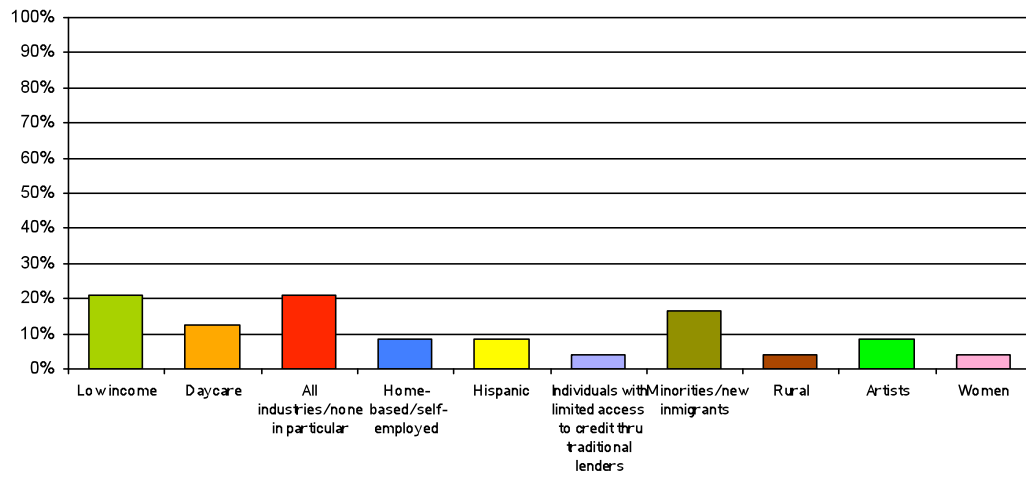


**Chart 19: Percentage of start-up clients**  
n=24

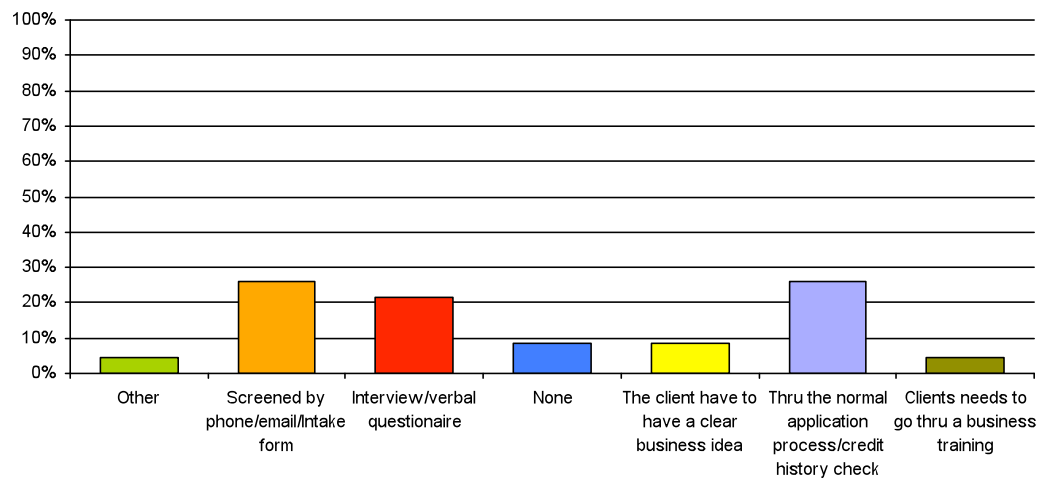




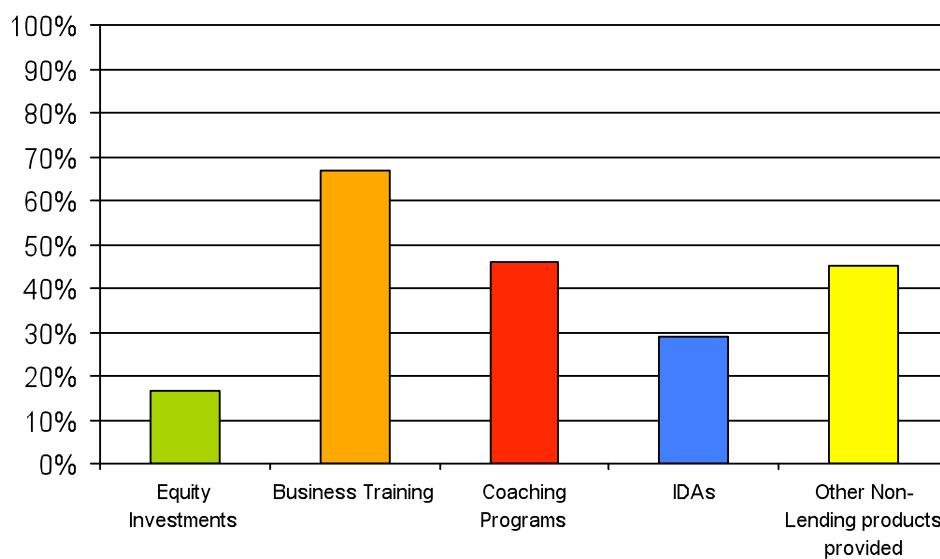
**Chart 20: Types of groups targeted for lending**  
n=24



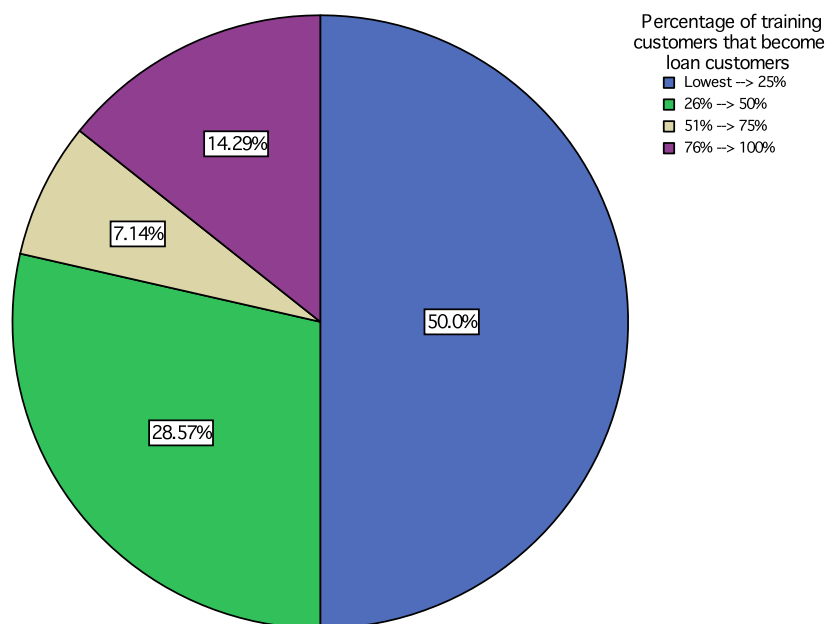
**Chart 21: Process for screening prospective customers**  
n=24



**Chart 22: Non-lending products offered**  
n=24

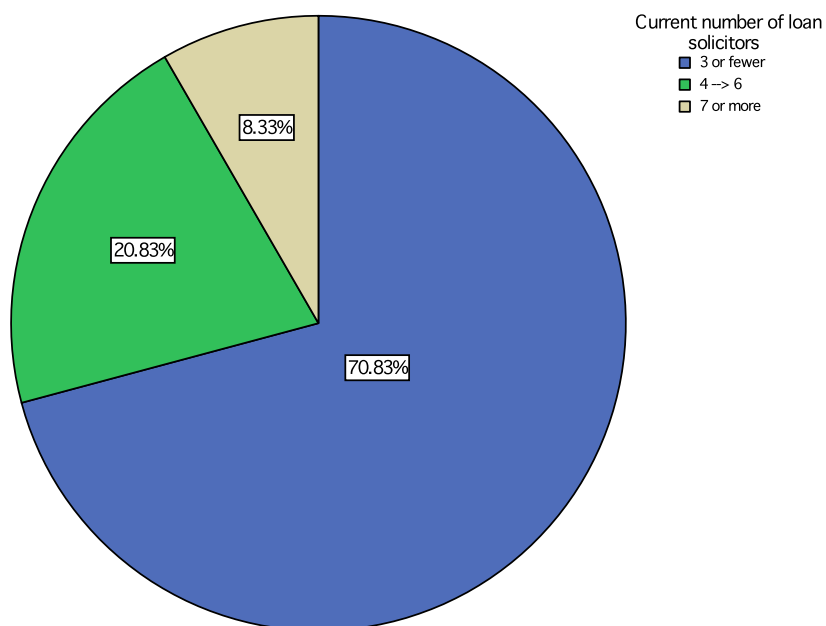


**Chart 23: Percentage of training customers that become loan customers**  
n=24

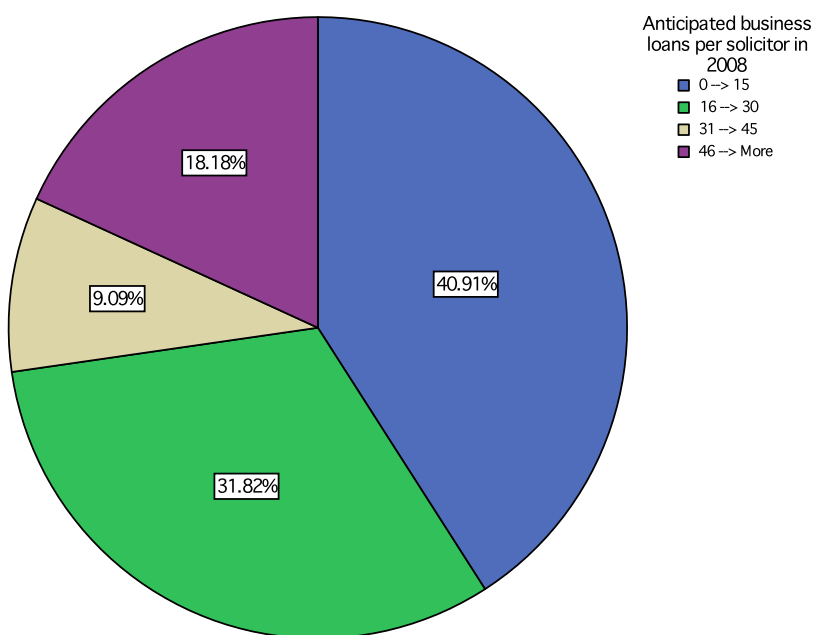


**LOAN SOLICITOR/UNDERWRITING PROFILE****Chart 24: Current number of loan solicitors**

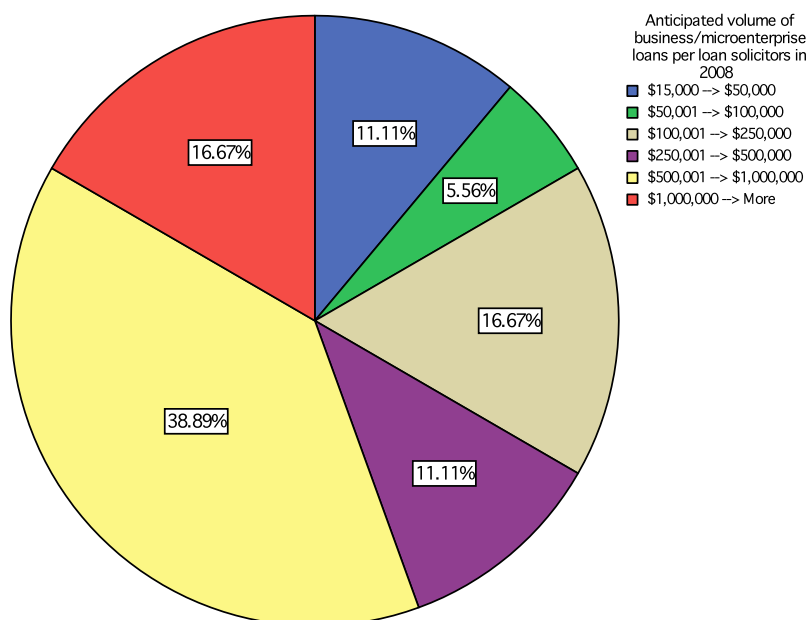
n=24

**Chart 25: Anticipated number of loans per solicitor in 2008**

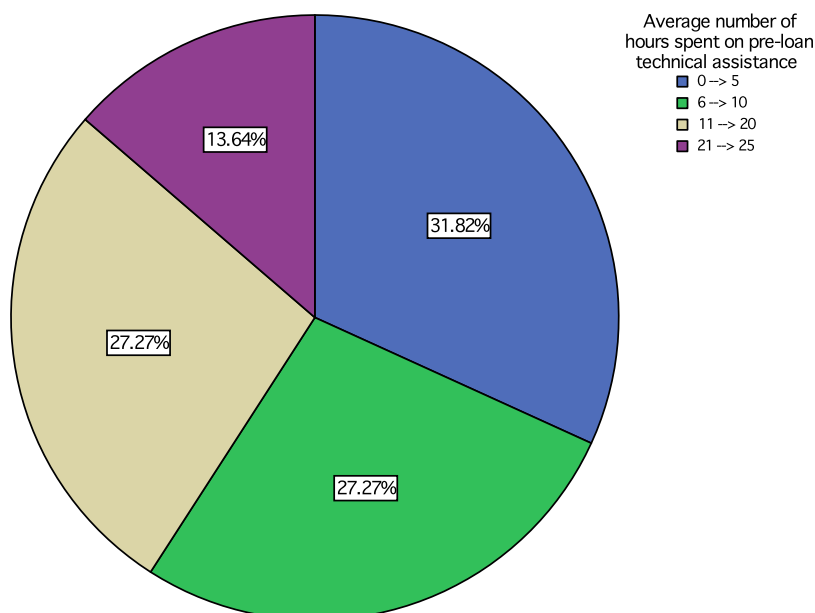
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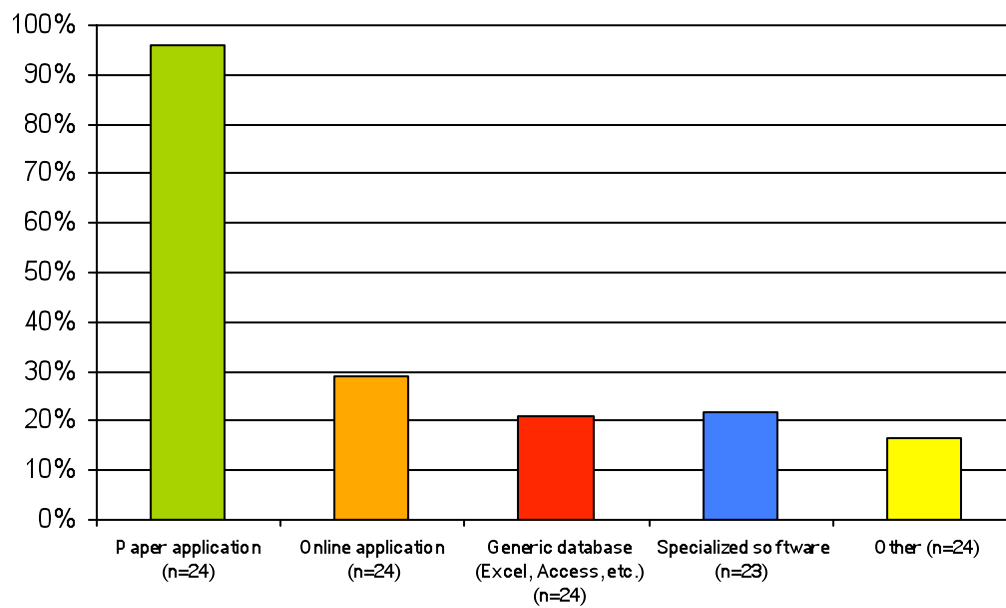
**Chart 26: Anticipated volume of loans per solicitor in 2008**  
n=24



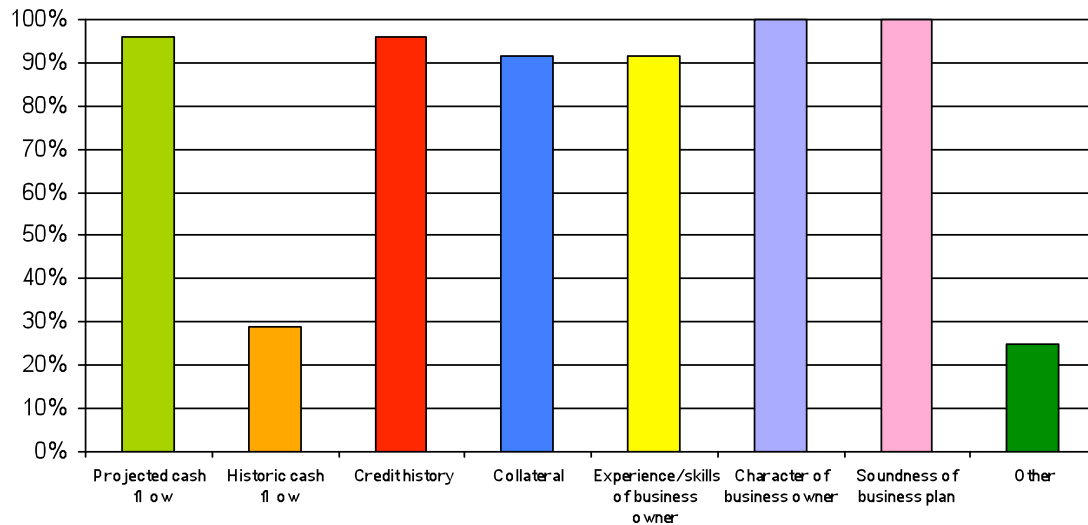
**Chart 27: Average number of hours spent on pre-loan technical assistance**  
n=24

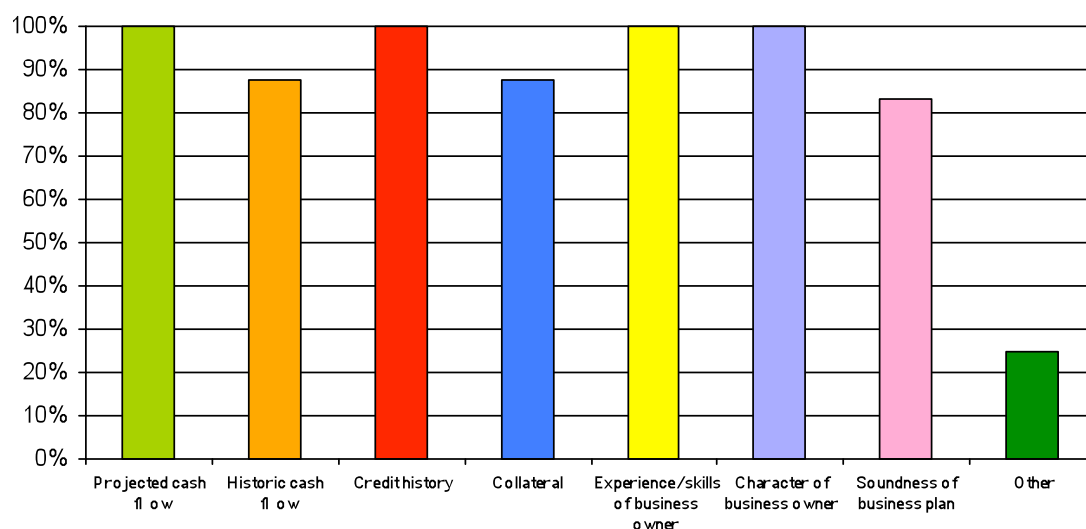
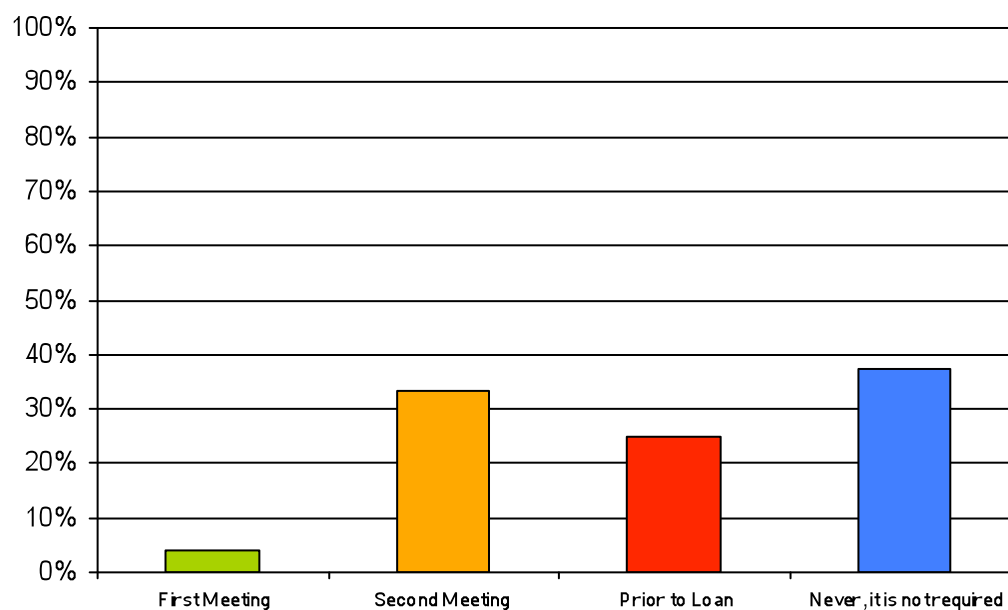


**Chart 28: How is information gathered from loan applicants?**  
n=24

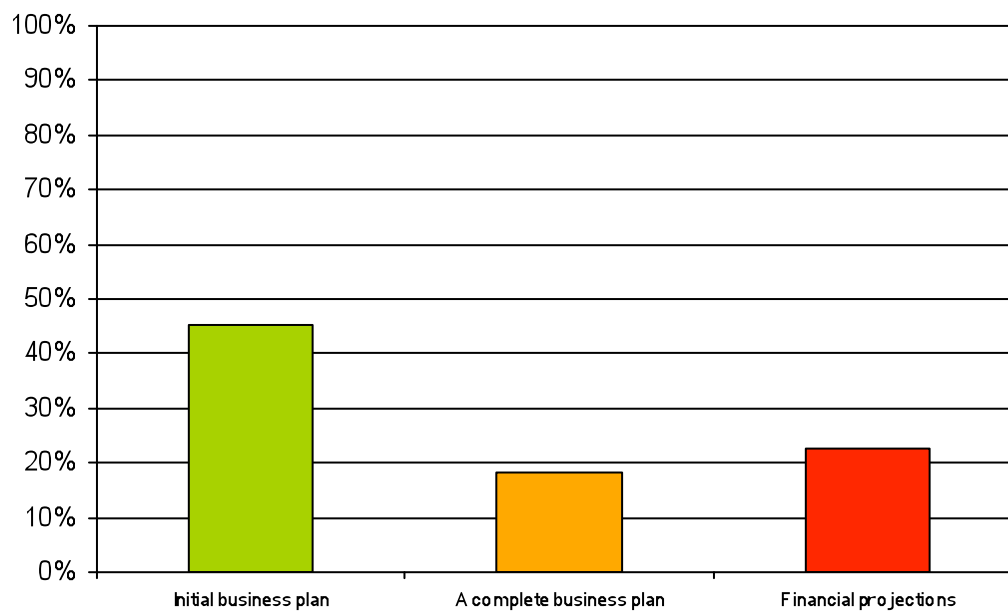


**Chart 29: Underwriting factors required for loan approval (Start-up businesses)**

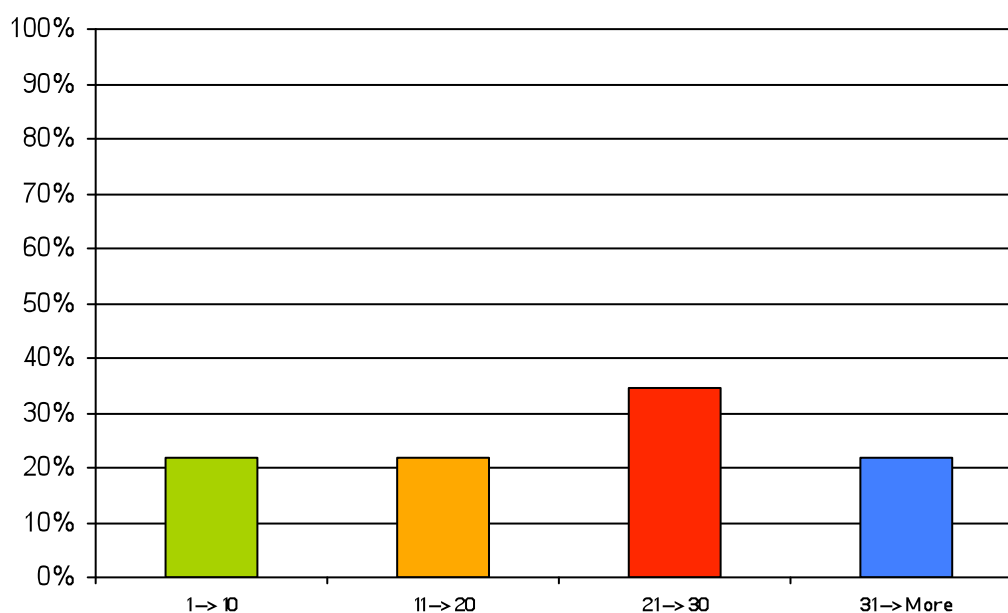


**Chart 30: Underwriting factors required for loan approval (Start-up businesses)****Chart 31: Underwriting factors required for loan approval (Existing businesses)**  
(n=24)

**Chart 32: Elements required prior to meeting with technical assistance staff**  
(n=24)

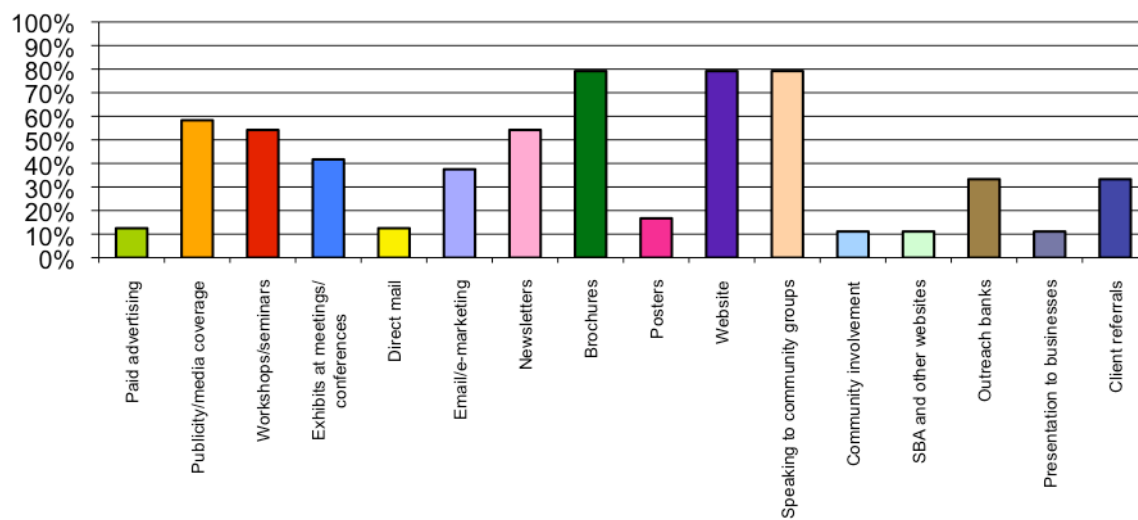


**Chart 33: Average number of days from completed application to loan disbursement**  
(n=24)

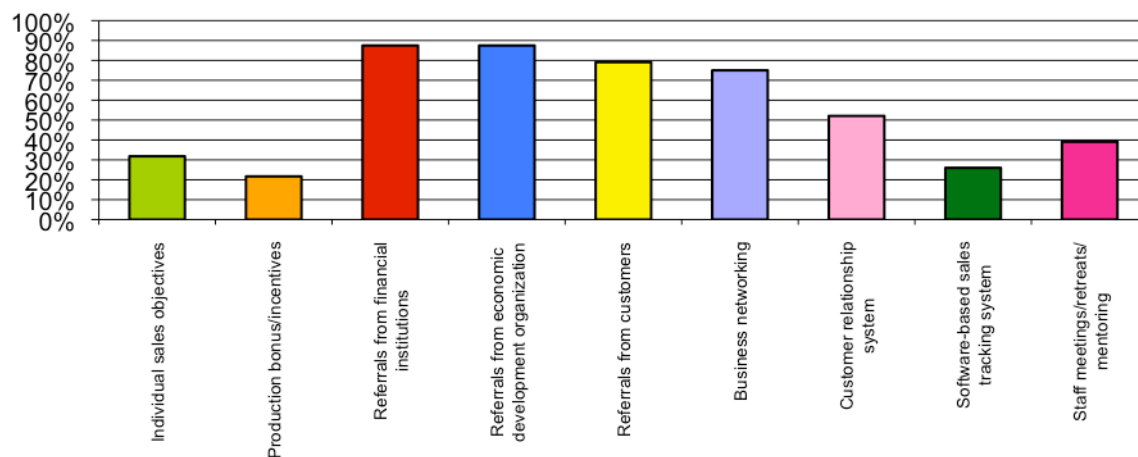


## MARKETING AND BUSINESS DEVELOPMENT/SALES STRATEGIES

**Chart 34: Top 2 marketing activities**  
(Percentage of respondents that considered the activity 'very important' or 'important')  
n=24

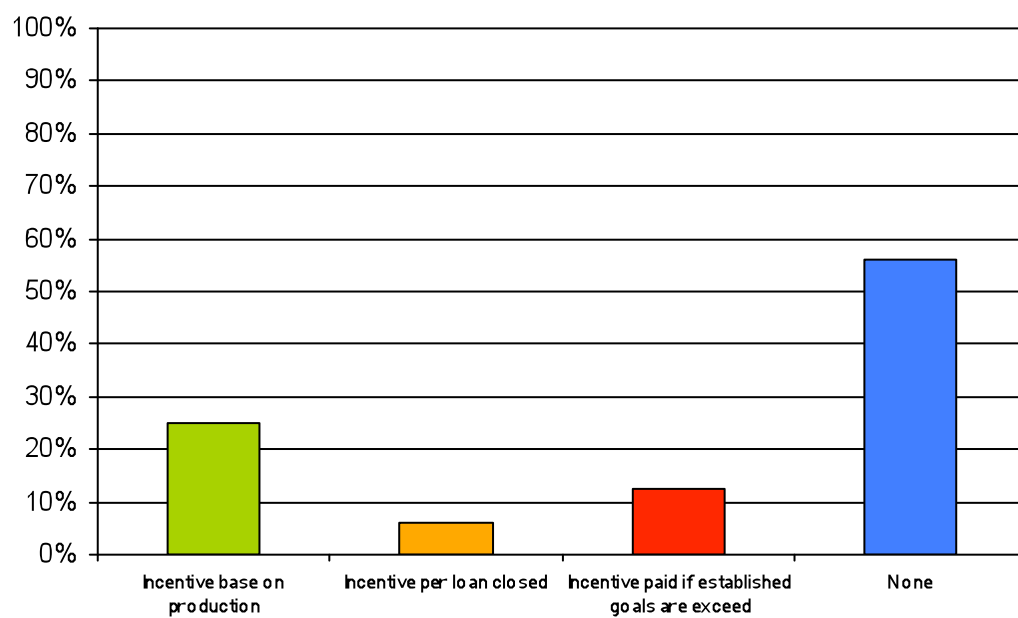


**Chart 35: Top 2 business development activities**  
(Percentage of respondents that considered the activity 'very important' or 'important')





**Chart 36: Incentive plans used for loan solicitors  
(n=24)**



## BEST PRACTICES AND EXPANSION OF MICRO-LENDERS

We assume that there are at least two main factors that are relevant in the process of expansion of a micro-lender:

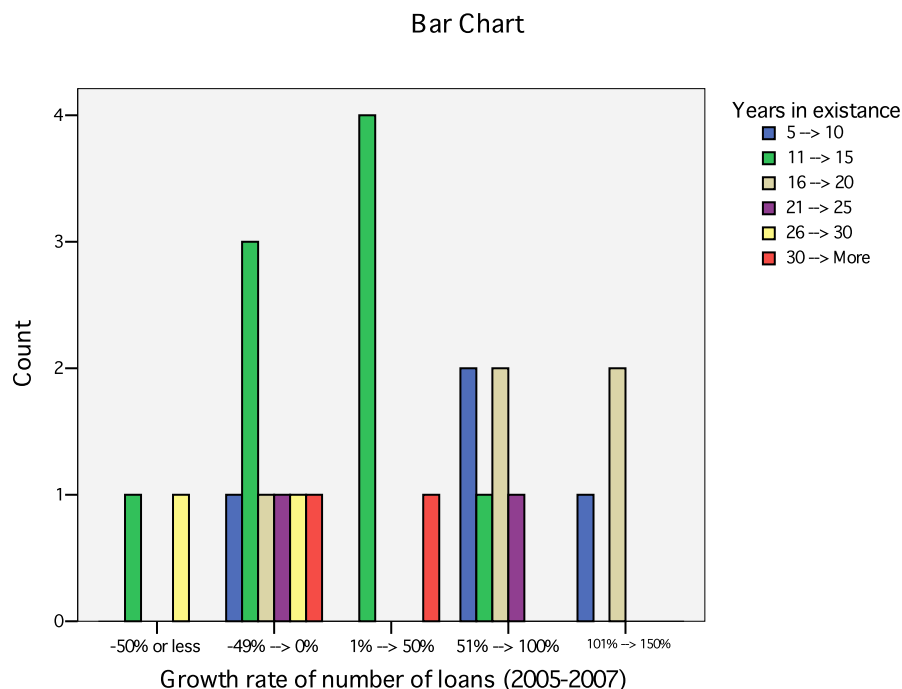
- a) **Market:** does demand for the planned expansion exist? How do we transform the potential demand into effective demand? What products satisfy the demand? What knowledge of actual and potential consumers do we have and need?
- b) **Productivity:** what “technology” is the most efficient/effective to take advantage of the effective demand for our products? Technology implies the processes used to deliver the products and services, for example the under-writing process, repayment strategies, or administrative procedures.

The results from the survey provide information on how micro-lenders deal with these two factors.

### *Characteristics of growing organizations*

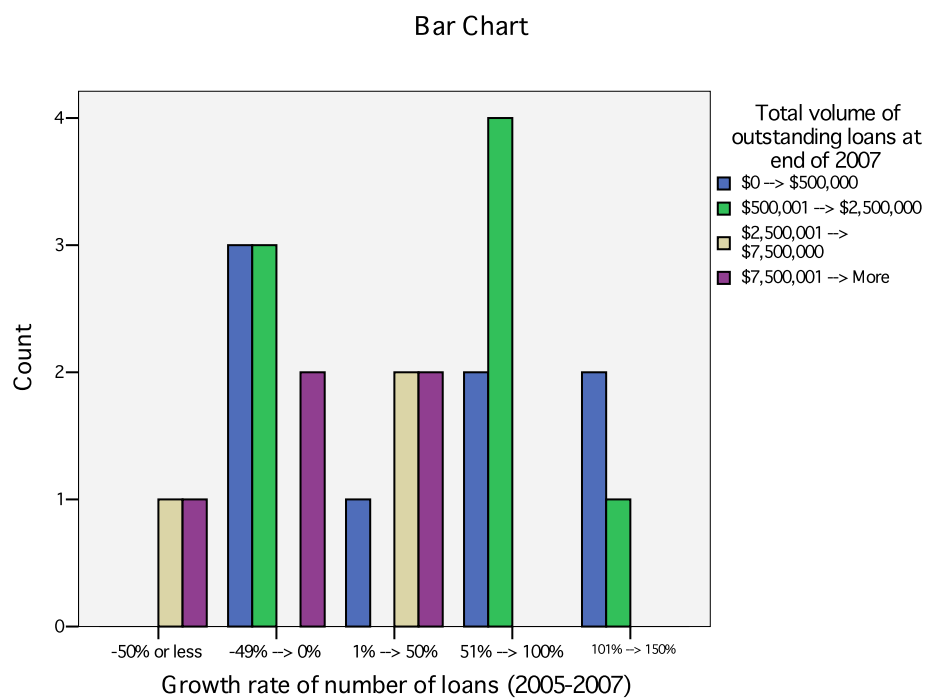
Younger micro-lending organizations (5 to 10 years in existence) tend to show positive rates of growth. Whereas, organizations with 11 to 15 years of existence showed lower rates of growth between 2005 and 2007 than younger organizations.

**Chart 37: Crosstab: Rate of growth of number of loans by Years in existence.**



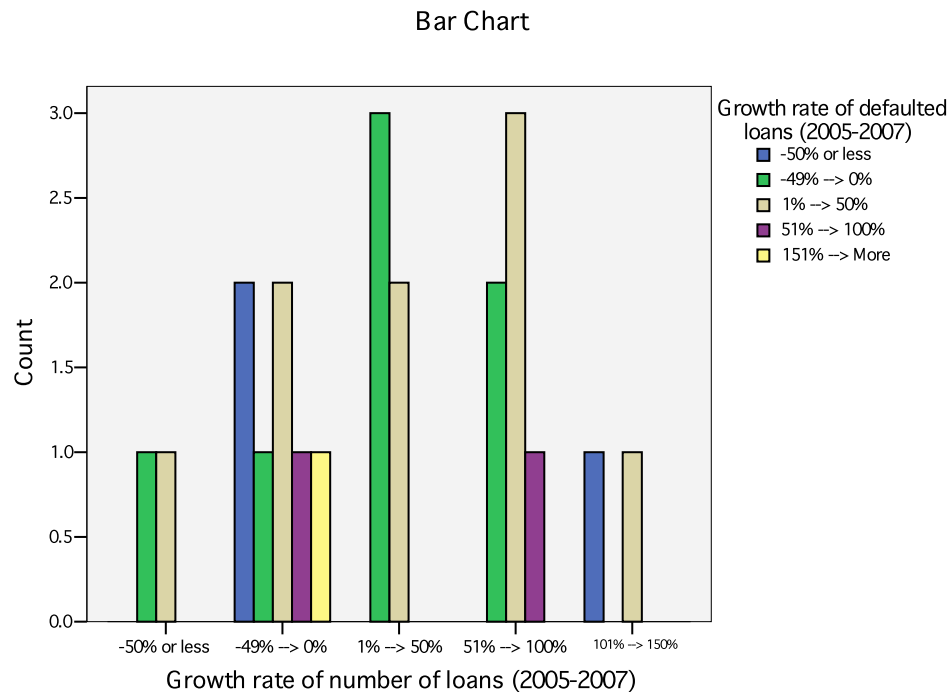
Micro-lenders with loan volumes between \$500,000 and \$2,500,000 showed higher rates of growth of number of loans between 2005 and 2007.

**Chart 38: Crosstab: Rate of growth of number of loans by Total volume of outstanding loans at the end of 2007**



Organizations that grew at faster rates between 2005 and 2007 also tend to show higher default rates between 1% and 50%. However, micro-lenders with moderate rates of growth (between 1% and 50%) showed a decline in their number of defaulted loans.

**Chart 39: Crosstab: Rate of growth of number of loans by Growth rate of defaulted loans (2005-2007)**

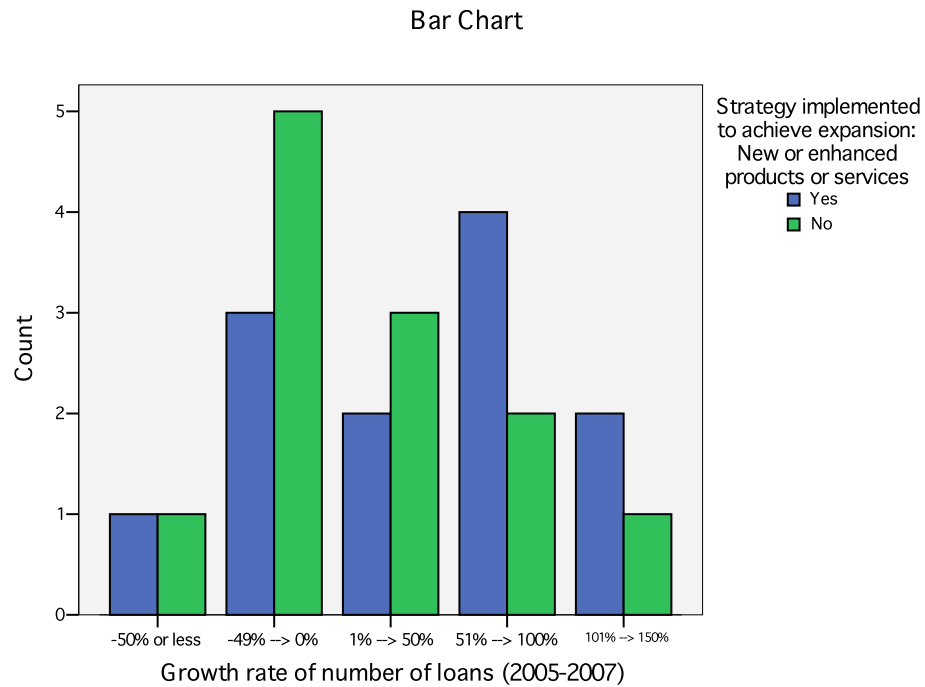


In general, micro-lenders that have less than 25% of minority clients (female, Hispanics, African-American, or rural households) tend to grow at lower rates during 2005 and 2007. However, the opposite is not confirmed by the data; that is, organizations with higher percentage of minority clients do not necessarily show the highest rates of growth. This might indicate that a more balanced clientele in terms of targeted groups seems to be more in accordance with fast growing micro-lenders.

### *Strategies to achieve expansion*

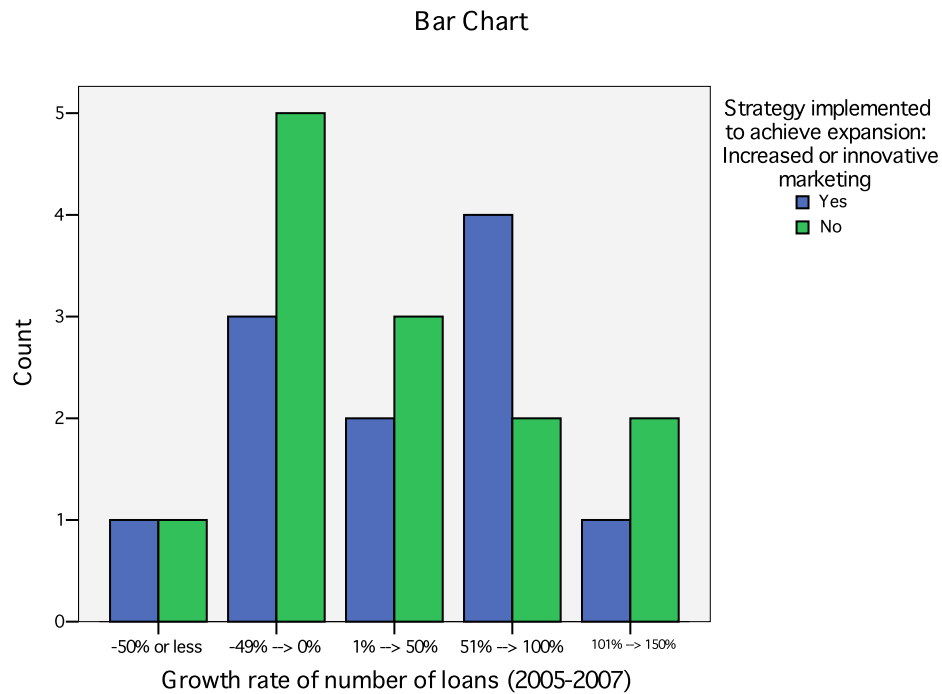
Organizations with higher rates of growth tend to implement new or enhanced products and services.

**Chart 40: Crosstab: Rate of growth of number of loans by New or enhanced products or services**



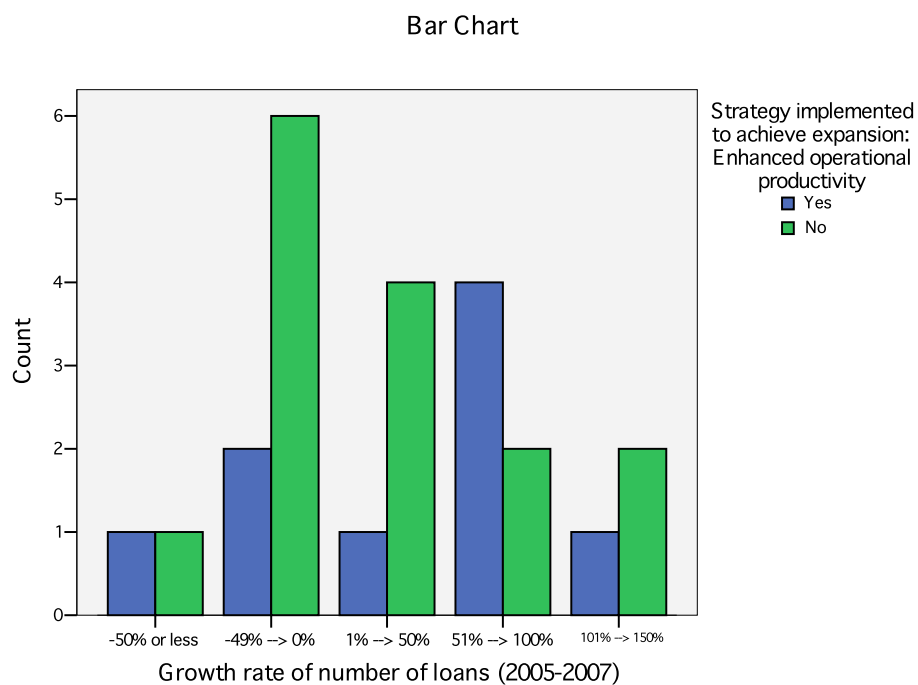
Marketing seems to be a defining characteristic of growing micro-lenders. Furthermore, organizations that declared that they have not implemented marketing activities tend to grow at slower rates than organizations that considered these activities important

**Chart 41: Crosstab: Rate of growth of number of loans by Increased or innovative marketing**



Micro-lenders growing at faster rates during 2005 and 2007 tend to implement strategies to improve their operational productivity.

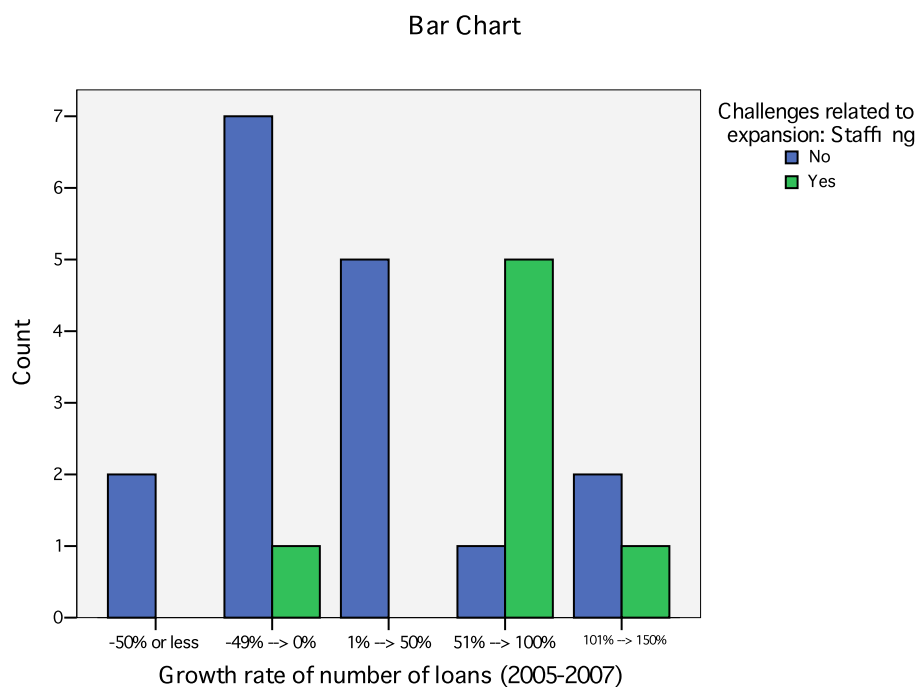
**Chart 42: Crosstab: Rate of growth of number of loans by Enhanced operational productivity.**



### *Challenges of expansion*

Staffing seems to be a challenge only for micro-lenders with high rates of growth of number of loans between 51% and 100%.

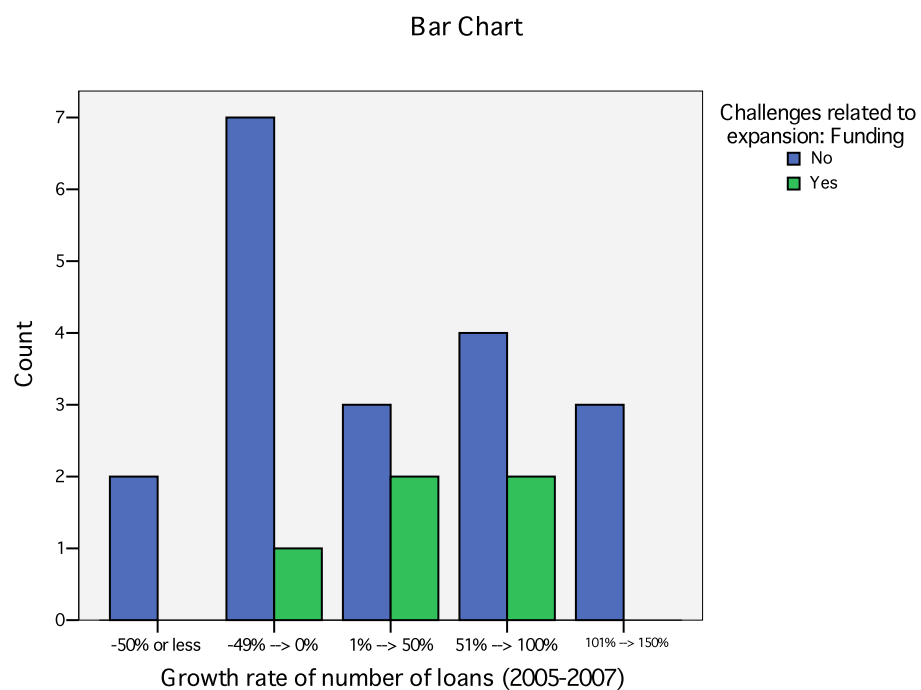
**Chart 43: Crosstab: Rate of growth of number of loans by Enhanced operational productivity.**





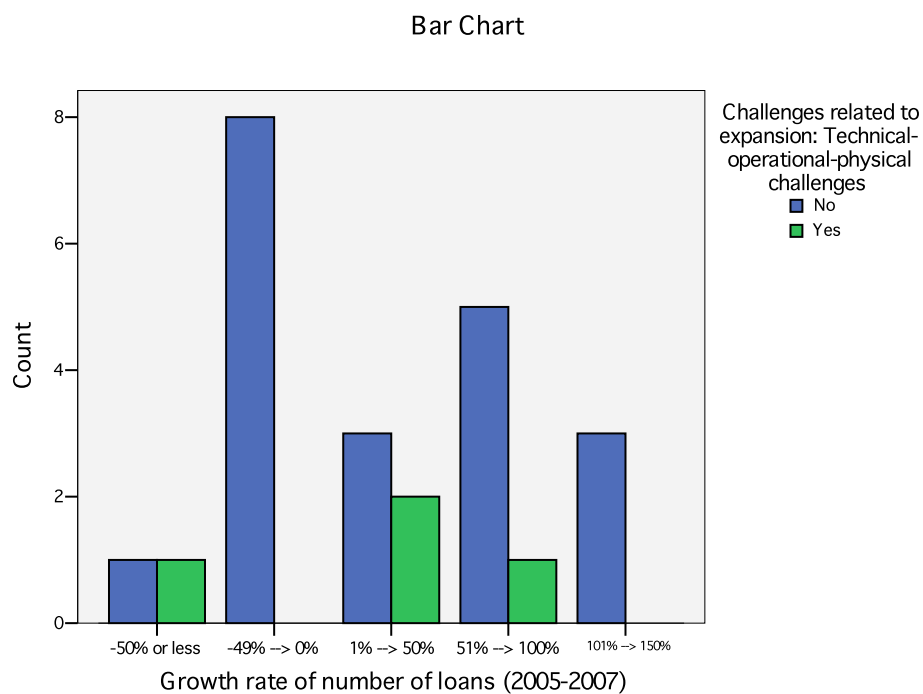
Micro-lenders with positive rates of growth expressed that funding was a challenge during the expansion period.

**Chart 44: Crosstab: Rate of growth of number of loans by Funding**



Some growing micro-lenders also indicated that they suffered some challenges regarding technical, operational, or physical space limitations.

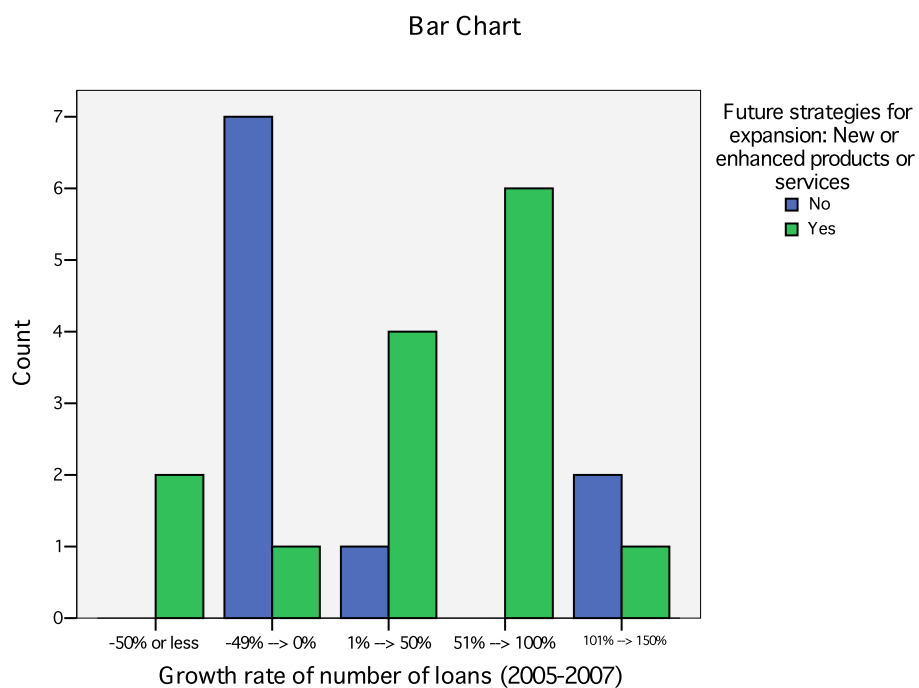
**Chart 45: Crosstab: Rate of growth of number of loans by Technical, operational, or physical challenges**



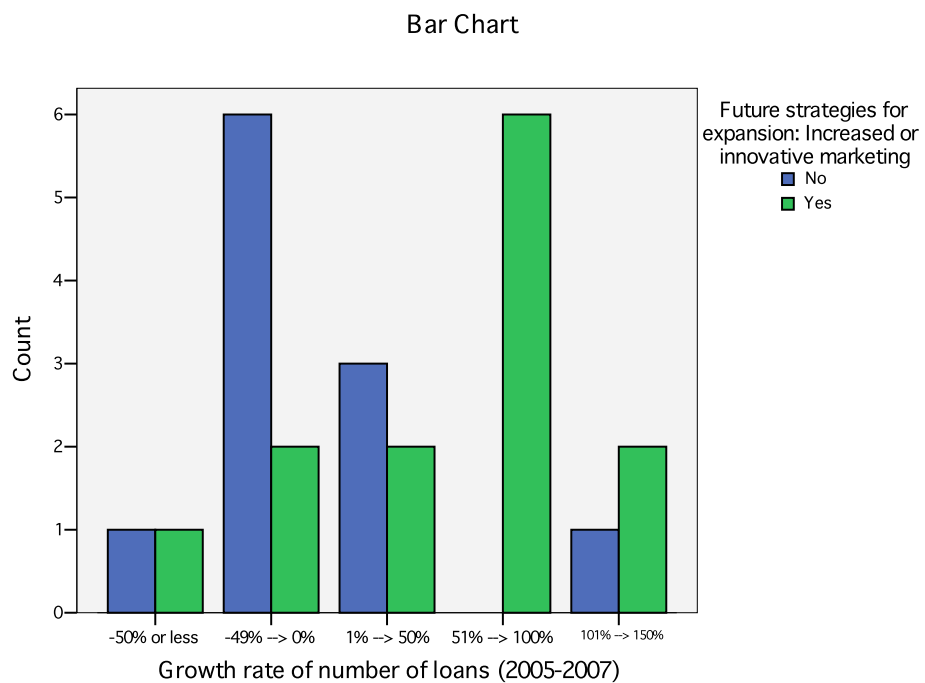
### *Strategies for future expansion*

When inquired about what strategies they are planning to implement to deal with future expansion micro-lenders mentioned the introduction of ‘new or enhanced products’ and ‘increased or innovative marketing’ as the two main strategies.

**Chart 46: Crosstab: Rate of growth of number of loans by New and enhanced products or services**

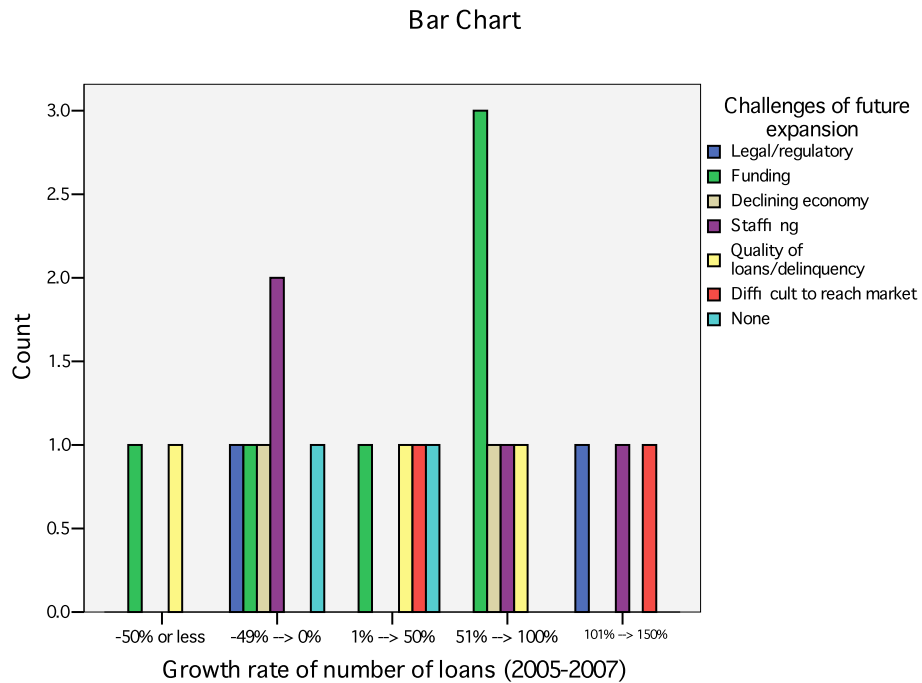


**Chart 47: Crosstab: Rate of growth of number of loans by Increased or innovative marketing**



Funding and staffing are the most common challenges for future expansion mentioned by all micro-lenders. While, among growing micro-lenders funding is the most important challenge for future expansion.

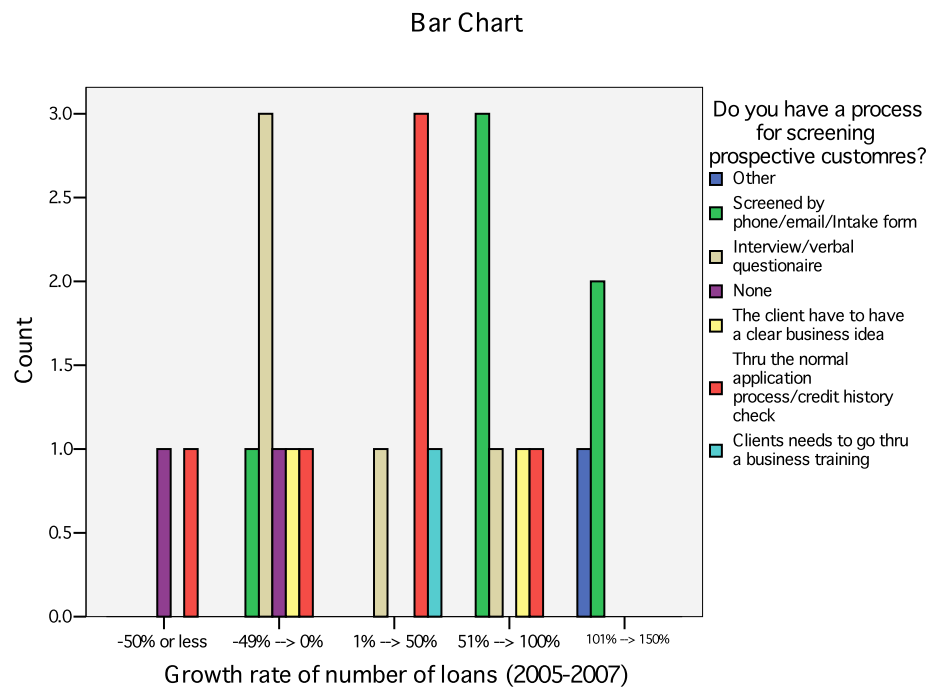
**Chart 48: Crosstab: Rate of growth of number of loans by Challenges of future expansion**



### *Productivity practices of growing micro-lenders*

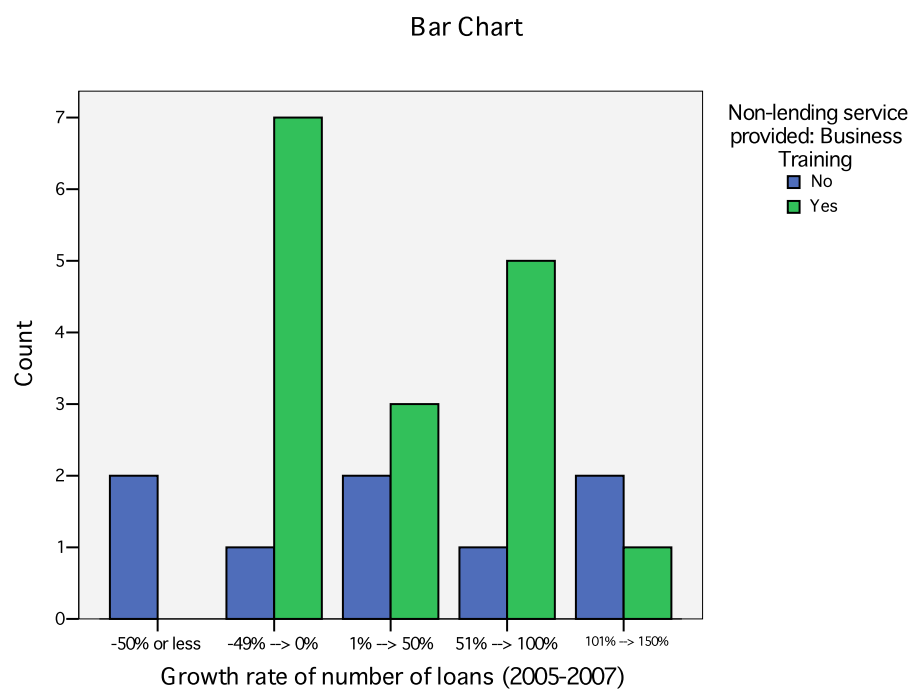
Fast-growing micro-lenders tend to screen their prospective clients by phone, intake form, or initial interview.

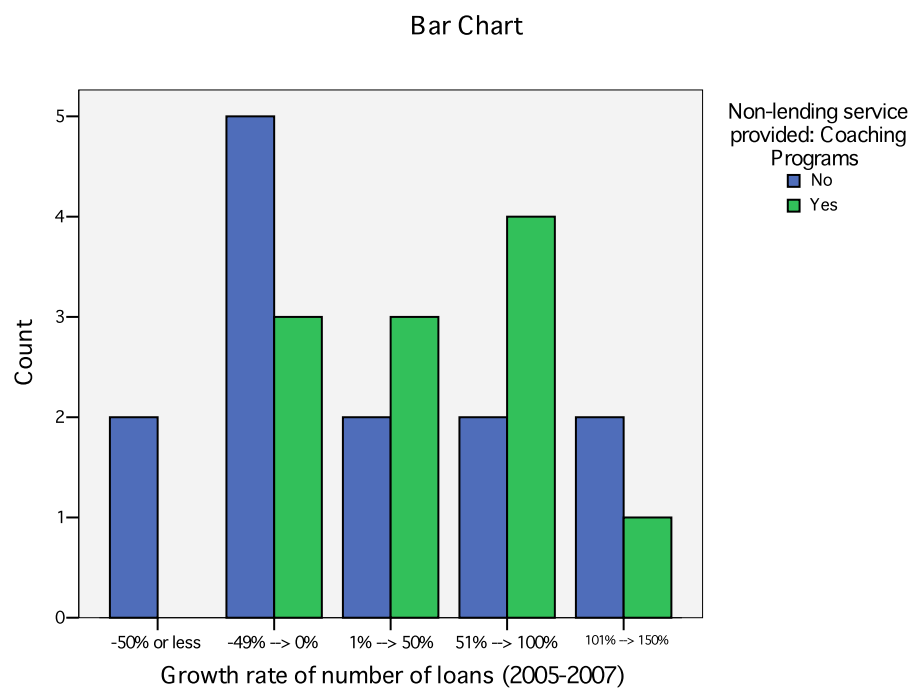
**Chart 49: Crosstab: Rate of growth of number of loans by Process for screening prospective clients**



Offering training and coaching programs is a common characteristic among micro-lenders with positive rates of growth in number of loans. However, micro-lenders that showed negative rates of growth also provided training.

**Chart 50: Crosstab: Rate of growth of number of loans by Business training**

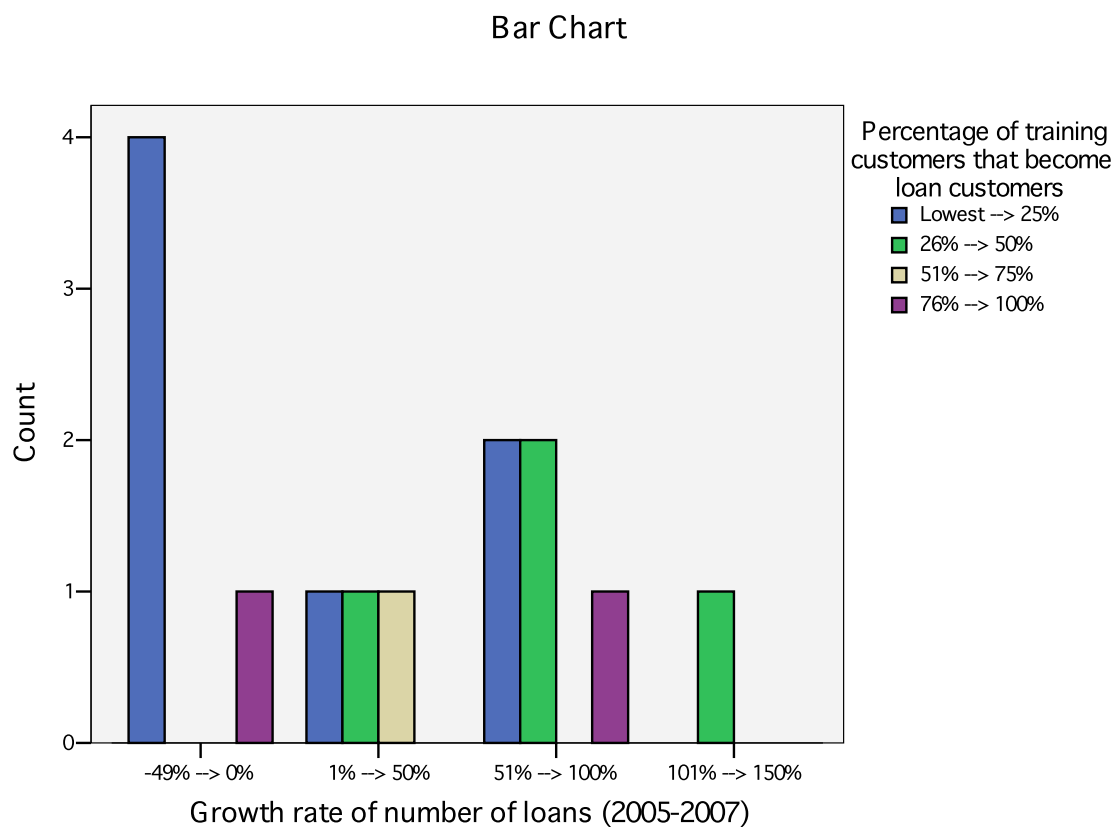


**Chart 51: Crosstab: Rate of growth of number of loans by Coaching programs**



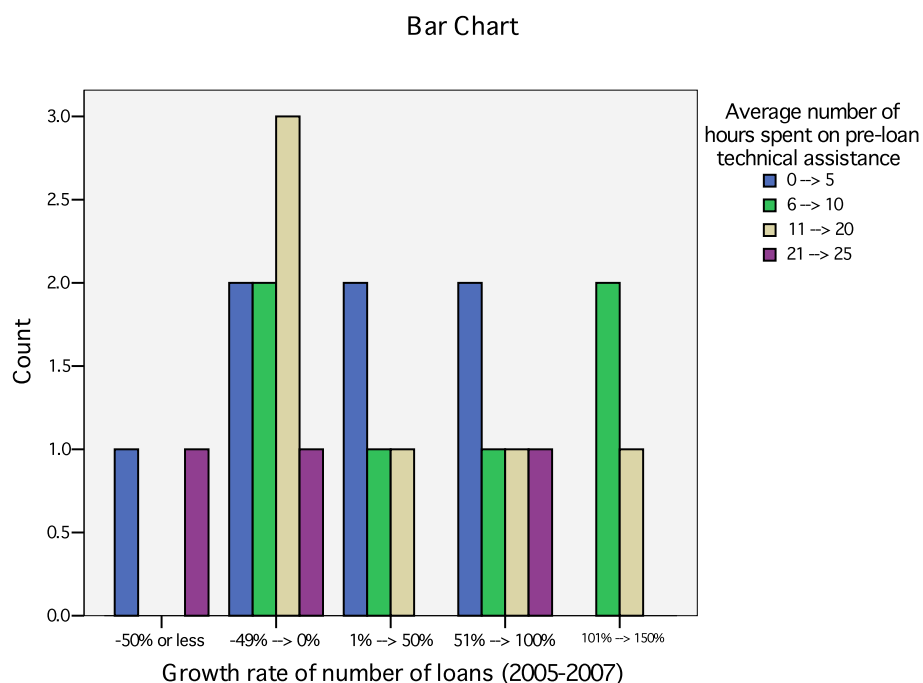
Micro-lenders which their training customers become loan customers more often tend to show higher rates of growth. However, fast growing micro-lenders also showed an increase in their default rates, thus successful migration from training to lending customers is not a guarantee for high impact results of micro-lending programs.

**Chart 52: Crosstab: Rate of growth of number of loans by Percentage of clients that become loan customers**



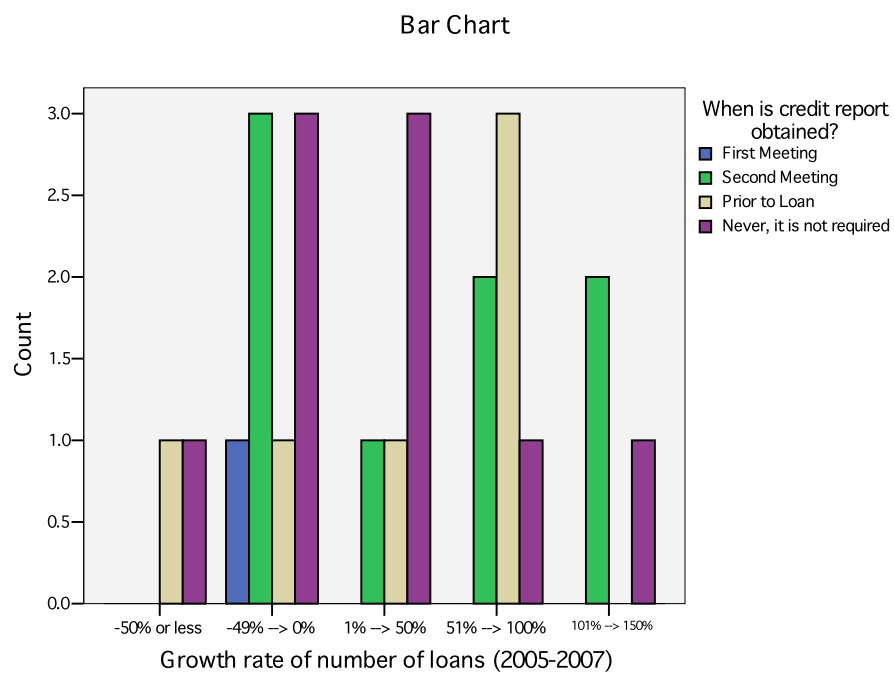
Organizations that spent more time in average providing pre-loan technical assistance showed lower rates of growth. However, more pre-loan assistance may be related to riskier projects or less qualified entrepreneurs. These factors may be related to the slower rates of growth.

**Chart 53: Crosstab: Rate of growth of number of loans by Average number of hours spent on pre-loan technical assistance**



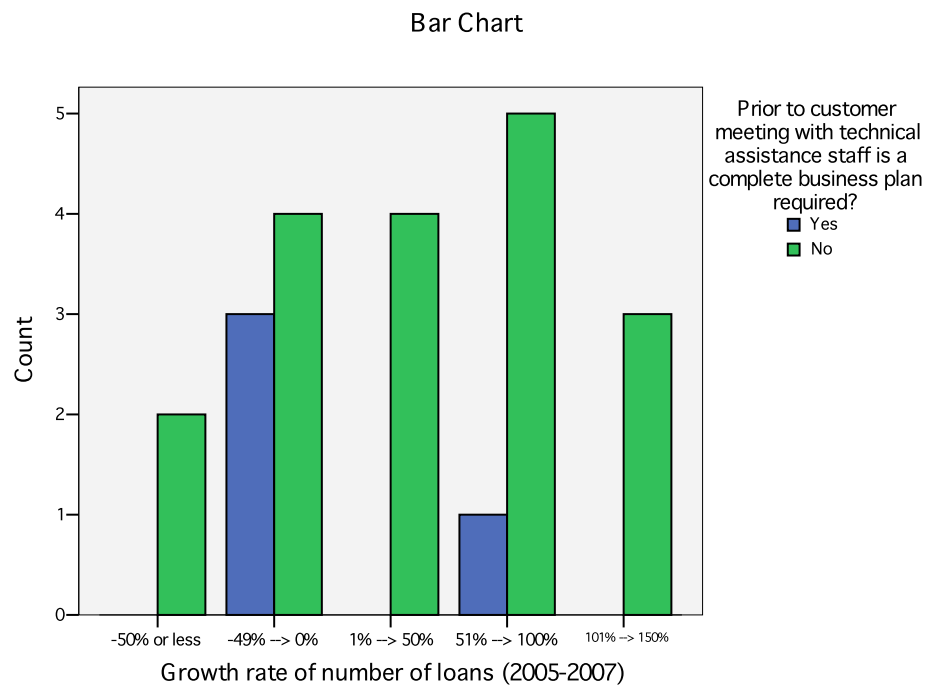
Revising client's credit report prior to loan is a common characteristic of fast growing micro-lenders.

**Chart 54: Crosstab: Rate of growth of number of loans by when is credit report obtained**



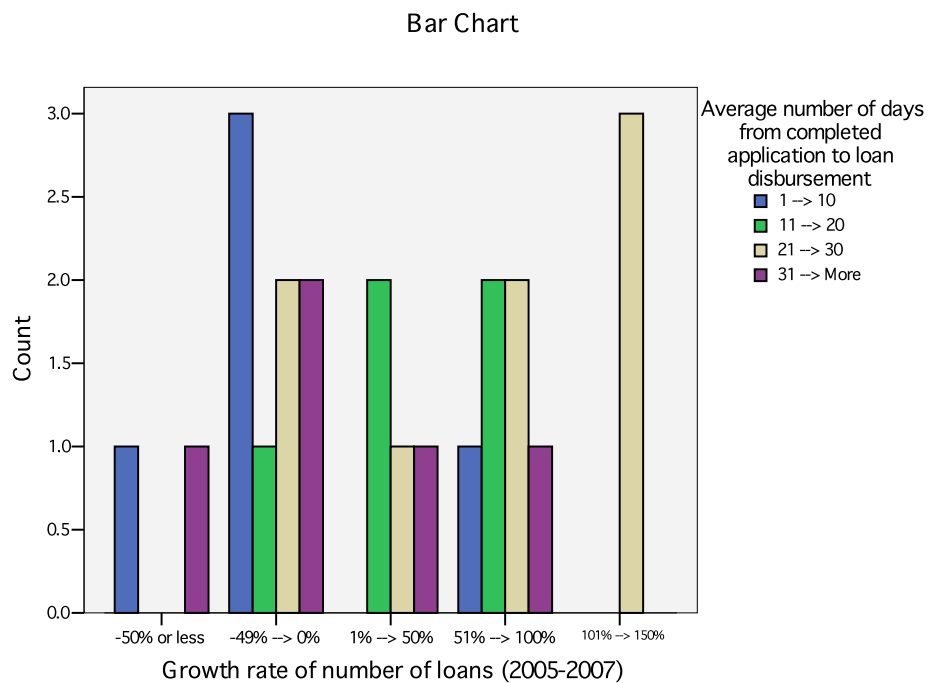
Asking clients for a complete business plan prior to meeting with technical assistance staff seems to slow down the growth in number of loans.

**Chart 55: Crosstab: Rate of growth of number of loans by Completed business plan required prior to meet with technical assistance staff**



Micro-lenders that take more time in average (21 days or more) from the application to the loan disbursement tend to grow at faster rates. This result may indicate that efficiency and growth are negatively related. Operational capacity may be a factor affecting these longer processing times. However, in the chart below we can also observe that organizations with faster ‘processing times’ showed negative rates of growth between 2005 and 2007. Thus, ‘too quick’ processing times may be related to other factors affecting growth.

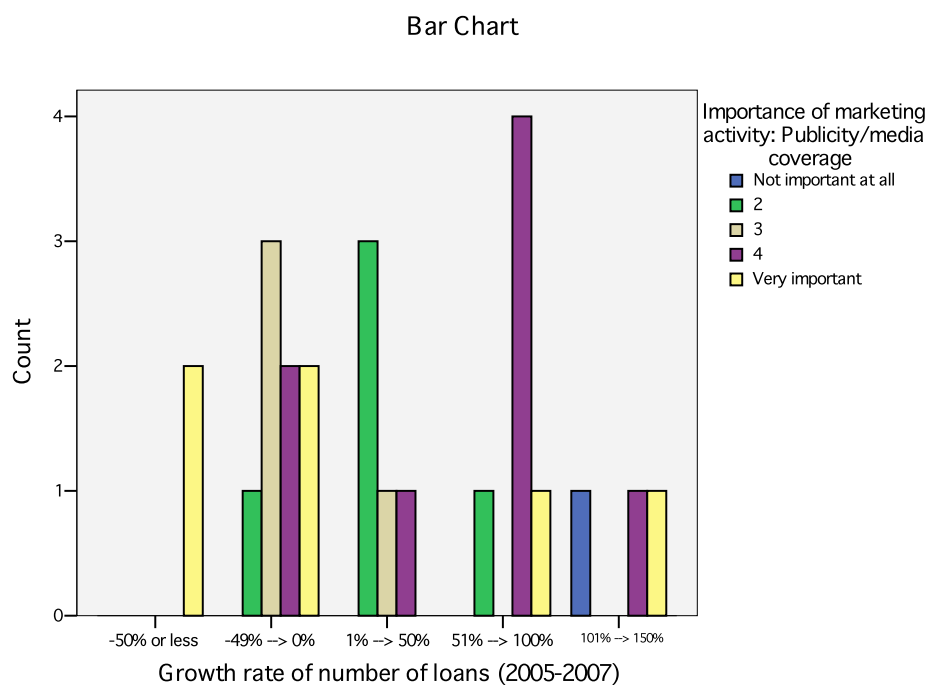
**Chart 56: Crosstab: Rate of growth of number of loans by Average number of days from completed application to loan disbursement**



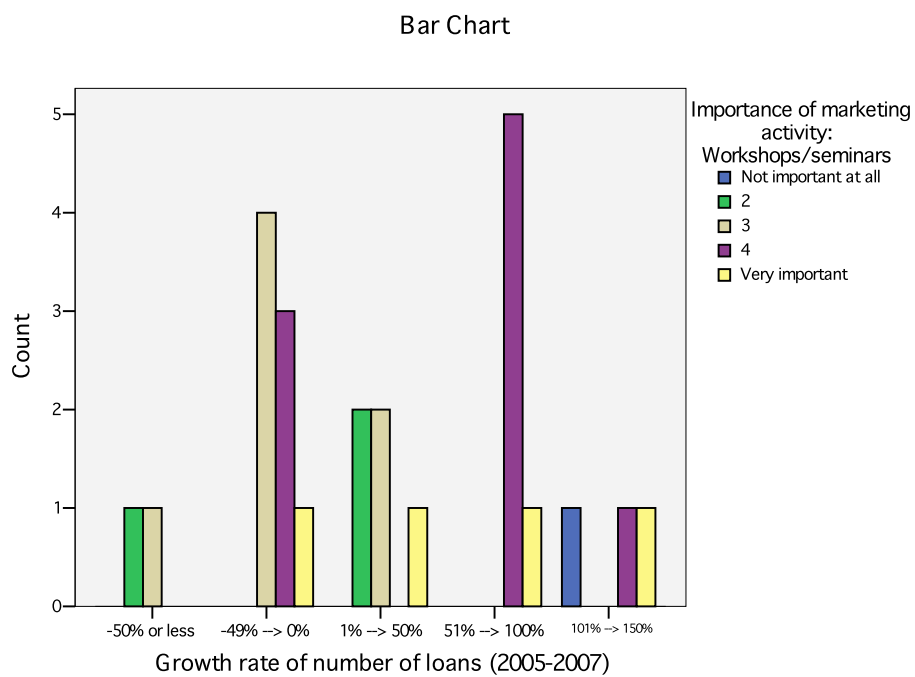
### *Marketing activities*

Micro-lenders with positive rates of growth consider ‘publicity and media coverage’ and ‘workshops and seminars’ as important or very important marketing activities.

**Chart 57: Crosstab: Rate of growth of number of loans by Importance of publicity/media coverage**



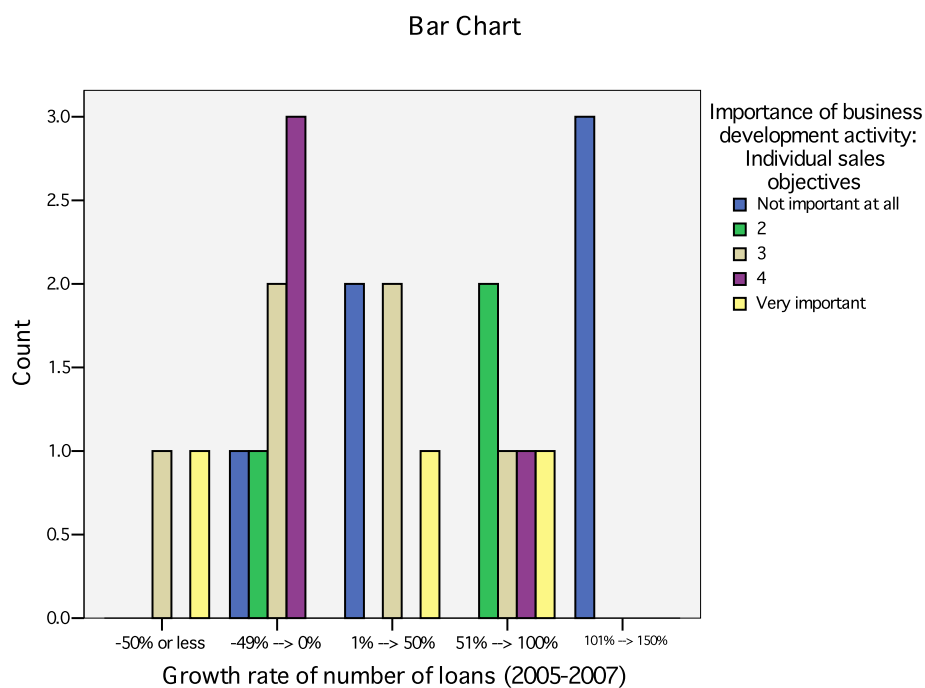
**Chart 58: Crosstab: Rate of growth of number of loans by Importance of workshops and seminars**



### *Business development activities*

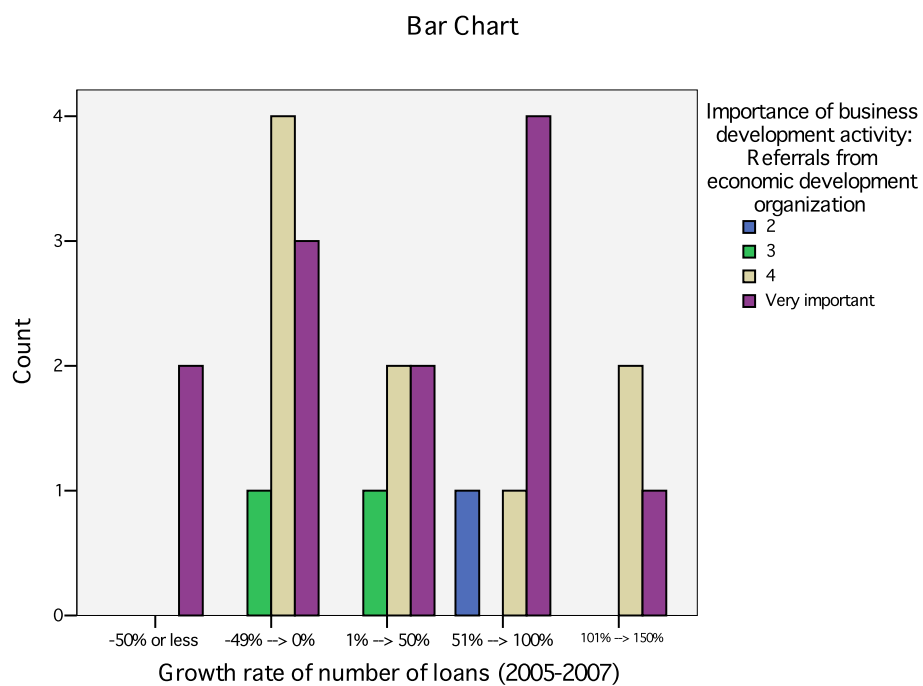
Organizations with high rates of growth consider that having individual sales objectives is not important as business development activity. Instead, micro-lenders considered that referrals from economic development organizations are important or very important factors of business development activities.

**Chart 59: Crosstab: Rate of growth of number of loans by Importance of individual sales objectives as business development activity**





**Chart 60: Crosstab: Rate of growth of number of loans by Importance of referrals from economic development organizations sales objectives as business development activity**



## INSTRUMENT

### QUESTIONNAIRE: Best practices for expansion in microlending

#### I. Organizational overview

1. What type of loans does your organization provide? (Check all that apply.)

- ☐ SBA microloans
- ☐ Non-SBA microloans
- ☐ Other non-SBA small-business loans
- ☐ Lines of credit
- ☐ Housing
- ☐ Consumer
- ☐ Community facilities
- ☐ Intermediary
- ☐ Other \_\_\_\_\_

*If your organization does not provide business or microenterprise loans, you do not have to complete the questionnaire. However, if you would like to receive a summary of the results of the research, please complete the contact information at the end of the questionnaire.*

2. Name of organization: \_\_\_\_\_

3. How many years in existence? \_\_\_\_\_

4. Number of employees: \_\_\_\_\_

5. Describe geographic area served: \_\_\_\_\_

6. Total volume of outstanding business/microenterprise loans at end of 2007: \$\_\_\_\_\_

7. Annual number of business/microenterprise loans closed (provide last 3 years if possible):

2005 \_\_\_\_\_ 2006 \_\_\_\_\_ 2007 \_\_\_\_\_

8. Annual total volume of business/microenterprise loans closed (provide last 3 years if possible):

2005 \$\_\_\_\_\_ 2006 \$\_\_\_\_\_ 2007 \$\_\_\_\_\_

9. Loan default rate (percentage of overall portfolio):

2005 \_\_\_\_% 2006 \_\_\_\_% 2007 \_\_\_\_%

10. Expected number of new business/microenterprise loans for 2008 (or current fiscal year): \_\_\_\_\_

11. Expected business/microenterprise loan volume for 2008 (or current fiscal year):

\$\_\_\_\_\_

## II. Loan expansion experience/plans

12. If you have experienced an expansion of your loan program over the past three years, what strategies, if any, did you implement to achieve this expansion? (Attach separate sheets if necessary.)

a.     \_ New or enhanced products/services. If so, please describe:

---

b.     \_ Increased or innovative marketing. If so, please describe:

---

c.     \_ Improved sales systems or methods. If so, please describe:

---

d.     \_ Enhanced operational productivity. Please describe:

---

e.     \_ Other. Please describe:

---

13. What challenges did the organization encounter as a result of this expansion of the loan program?

---

14. If you have plans to expand your loan program over the next three years, what strategies, if any, do you plan to implement to achieve this expansion?

a.     \_ New or enhanced products/services. Please describe:

---

b.     \_ Increased or innovative marketing. Please describe:

---

c.     \_ Improved sales systems or methods. Please describe:

---

d.     \_ Enhanced operational productivity. Please describe:

---

e.     \_ Other. Please describe:

---

15. What challenges do you foresee as a result of this future expansion of the loan program?

---

16. Any other comments you'd like to provide about your organization's loan program? (If you have an annual report or company brochure available, you may include it with this questionnaire.)

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### III. Customer profile

17. Please provide an approximate demographic profile of your loan customer base, *in percentages*:

a. Gender:    \_\_\_% Male                   \_\_\_% Female

b. Ethnicity:   \_\_\_% White                   \_\_\_% Hispanic  
                   \_\_\_% African-American       \_\_\_% Asian-American  
                   \_\_\_% Native American       \_\_\_% Other/multi-racial

c. Location:   \_\_\_% Rural    \_\_\_% Urban

d. Stage of business: \_\_\_% Start-up businesses   \_\_\_% Existing businesses

18. Do you target any types or groups of businesses for lending? If so, list or describe:

---

19. Do you have a process for screening prospective customers? If so, describe:

---

20. Which, if any, non-lending services are offered by your organization? (Check all that apply.)

- ☐ Equity investments
  - ☐ Business training programs. Required to apply or receive loans? ☐ Yes ☐ No
  - ☐ Coaching programs. Required to apply or receive loans? ☐ Yes ☐ No
  - ☐ Individual Development Accounts (IDAs)
  - ☐ Other: \_\_\_\_\_
- 

21. If you offer business training, approximately what percentage of your training customers become loan customers?   \_\_\_ %

### IV. Loan solicitation/underwriting profile

22. Current number of loan solicitors (loan officers): \_\_\_\_\_

23. Anticipated number of business/microenterprise loans per loan solicitor in 2008:  
     No \_\_\_\_\_

24. Anticipated business/microenterprise loan volume per loan solicitor in 2008:  
     \$ \_\_\_\_\_

25. Average number of hours spent on pre-loan technical assistance: \_\_\_\_\_

26. How is information gathered from loan applicants? (Check all that apply.)

- ☐ Paper application
- ☐ Online application
- ☐ Generic database (e.g., Excel, Access, etc.)

☐ Specialized software (off-the-shelf or customized)

☐ Other: \_\_\_\_\_

27. Are the following underwriting factors required in the loan approval process?

	<u>Start-up business</u>	<u>Existing business</u>
Projected cash flow	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
Historic cash flow	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
Credit history	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
Collateral	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
Experience/skill of business owner	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
Character of business owner	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
Soundness of business plan	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
Other _____	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No

28. When is a credit report obtained?

☐ First meeting      ☐ Second meeting  
☐ Prior to loan      ☐ Never, it is not required

29. Prior to a customer meeting with technical assistance staff, are the following required?

Initial business plan      ☐ Yes ☐ No  
Complete business plan      ☐ Yes ☐ No  
Financial projections      ☐ Yes ☐ No

30. What is the average time from completed application to loan disbursement?  
\_\_\_\_ days

## **V. Marketing and business development/sales strategies**

31. How important are these marketing activities to your organization's loan program?

*Marketing activity*      *mark one (1 = Not all important, 5 = Very important):*

1      2      3      4      5

Paid advertising  
Publicity/media coverage  
Workshops/seminars  
Exhibits at meetings/conferences  
Direct mail  
Email/e-marketing  
Newsletters  
Brochures/other printed material  
Posters  
Web site  
Speaking to community groups  
Other \_\_\_\_\_

32. How important are these business development strategies to your organization's loan program?

*Business development strategy mark one (1 = Not all important, 5 = Very important):*

1      2      3      4      5

- a. Individual sales objectives
- b. Production bonus/incentives
- c. Referrals from financial institutions
- d. Referrals from economic development organizations
- e. Referrals from customers
- f. Business networking
- g. Customer relationship system
- h. Software-based sales tracking system
- i. Staff meetings/retreats/mentoring
- j. Other \_\_\_\_\_

33. Describe any incentive plan used for loan solicitors:

---

**Would you (or someone else in your organization) be willing to participate in a brief follow-up interview?**

Contact name: \_\_\_\_\_  
 Title: \_\_\_\_\_  
 Phone \_\_\_\_\_ Email: \_\_\_\_\_

**Would you (or someone else in your organization) like to receive a report summarizing the findings of this survey (ready summer 2008)?**

Contact name: \_\_\_\_\_  
 Title: \_\_\_\_\_  
 Phone \_\_\_\_\_ Email: \_\_\_\_\_  
 or Mailing address:  
 Street \_\_\_\_\_  
 Suite \_\_\_\_\_  
 City \_\_\_\_\_  
 State \_\_\_\_\_  
 Zip code \_\_\_\_\_

**THANK YOU for your participation in this survey!**